BANKING CONCENTRATION

IN THE

UNITED STATES

A Critical Analysis

By

JOSEPH STAGG LAWRENCE,

Author of

"Stabilization of Prices"

"Wall Street and Washington"

New York

The Bankers Publishing Company

PRINTED IN THE UNITED STATES OF AMERICA
WARREN PUBLICATIONS PRESS
CAMBRIDGE, MASS

PREFACE

THE completion of a book always leaves an author under a heavy burden of debt to the many who have aided in the task. It is never possible to make complete and appropriate acknowledgment of all this assistance. In this case there is conspicuous indebtedness which courtesy and gratitude compel me to recognize. The Brookings Institution has been unfailing in its courteous co-operation at all stages of my task and extraordinarily tolerant of my eccentricities as a worker. The statement of my debt to this organization would be incomplete without specific mention of Dr. H. G. Moulton and Dr. C. O. Hardy. Their scholarly criticism and sense of proportion have been invaluable guiding points in the preparation of the work. In addition to the personal efforts of Dr. Moulton and Dr. Hardy the Brookings Institution made a substantial financial contribution to my labors without which it is hardly likely that the work could have been undertaken.

At home I have leaned heavily upon Colonel David M. Flynn, President of the First National Bank of Princeton, for a development of the practical problems which confront the small bank and an appreciation of the part which it plays in the

life of the community. This splendid bank has, in a sense, been the author's laboratory and he is grateful to it and its officers for their many courtesies.

My bill of obligations would be incomplete without mention of Mr. Theodore Prince whose fine intelligence and broad experience have been placed generously at my disposal. To Mr. Robert M. Laas and Mr. Robert S. Byfield of Ames, Emerich & Company I am indebted for many discussions of the portfolio problems of American banks.

I am alone responsible for the views expressed and conclusions developed.

JOSEPH STAGG LAWRENCE

Princeton, N. J.
Oct. 26, 1930.

SUMMARY OF CONTENTS

CONTENTS

CONTENTS

CONTENTS

CONTENTS

CONTENTS

CONTENTS

CONTENTS

CONTENTS

CONTENTS

CHAPTER I

Banking Concentration—The Problem

Self interest plus a more detached general concern for the fate of our banking institutions has invested the phenomenon of banking concentration with a measure of vital import which has focused public attention upon it. In a nation where approximately 95 per cent. of all business transactions are settled by check, where the humblest worker carries a bank account, where the bank and its facilities are the indispensable enabling instruments by which the pace of modern enterprise can alone be sustained, it is only natural that a profound structural change should arrest attention and command study.

This Study Essentially Analytical

The subject has not been neglected. Unfortunately, all the emphasis has been placed upon historical and quantitative developments and little upon analysis saving only the controversial and opinionated views of those whose disinterestedness was open to question. We have heard a great deal of the growth of chains, of groups and branches. Little has been established of the threat or promise

which it contains. The statements of the present Comptroller on the relative merits of large and small scale banking have been vigorously challenged by the small banker. On these problems the writer hopes to cast some light. He will state here his general conclusions and indicate his methods and leave to subsequent chapters in the study the presentation of evidence and the detailed demonstration of these conclusions.

Small Banks Destined to Disappear?

Arguing from analogy with banking systems of other countries, the nature of unit and multiple banking, their mutually exclusive character, the greater public tolerance of all forms of business concentration and the very distinct present trend it appears that small scale banking is destined to disappear before the encroachments of large scale banking. The movement toward banking concentration has been held in suspense for many years. If we take the resources of the average bank in 1925 and subject them to the deflating process, *i. e.*, make allowance for the change in the value of the dollar, we will find that the bank of 1925 is no larger than the bank of 1900. Its growth has been an illusion. Its stationary position a fact. The banks of the country as a whole have shown no sympathetic response to the growth of business. The latter, therefore, except in certain minor

respects cannot be accounted the cause of the present concentration in banking.

End of Movement

Now that the movement is definitely under way it is impossible to say how soon it will achieve the ultimate, *i. e.*, a position comparable to the Canadian and English banking systems. Our unit banks have been nourished under the jealous protection of our federal and most state laws during a period of 60 years in which the systems of other nations have been free to pursue centripetal inclinations The unit system has sunk its roots deep into the consciousness of the American community. As a reality the independence of the unit bank may shortly disappear, assuming legislative complaisance. In view of our cherished preposessions the fiction of independence may have to be maintained for many years.

Large Banks and the "Genius" of the American People

American history fails to support the contention that large scale multiple banking is incompatible with the genius of the American people. That there is some intrinsic temperamental repugnance to the great bank with branches fails to survive our examination. We had elaborate branch systems in this country prior to the Civil War. Some of them were highly successful. The State

Bank of Ohio and the State Bank of Indiana are cases in point. Both the First and Second United States Banks had branches and there were many others. Not that branch banking even where tolerated was regarded with any measure of enthusiasm. In those dark ages of banking when we were struggling to purge the profession of overwhelming abuses it was found that the branch form of organization provided a latitude for the dishonest and unscrupulous banker which rendered the regulation of the state ineffective and the protection of the bank client virtually impossible.

Banking Abuses and Early Branch Systems

The best safeguard of the client then as now was his own judgment of the character of the banker. Prudence required that the banker's character and conduct be kept under constant scrutiny. The branch system with absentee ownership made this observation impossible. Again the branch form of organization facilitated the manipulation of capital funds so that the capital of a single unit in the system, by being shifted from branch to branch in advance of the examiner, whose movements were carefully watched, often sufficed for the entire system. Finally the branch organization aggravated the currency disorders of the day. Notes issued by one inaccessible branch were paid out by another distant and equally inaccessible branch.

Hostility to Early Branch Banking

The northern states soon lost patience with the branch organization and passed strict prohibitory laws. The more lenient commonwealths of the South retained their branch systems until the Civil War. When the National Banking Act was passed the many abuses noted during the pre-Civil War period were excluded. Among the offending bank practices which were lined up in the courtyard at sunrise was branch banking. However, the abuses which then operated through the greater latitude of the branch system and endowed it with unsavory repute have been eliminated. The verdict of American history as to the relative merits of branch and unit banking is open. There can be no question but that the American character as such was perfectly capable of tolerating the branch system.

Survival of Feeling

The feeling against the great bank with its numerous branches as well as chain and group banking has survived the three generations since the establishment of the National Banking System. The grounds of opposition have changed. During the last two or three years the vitality of that opposition has suffered. When large scale banking first attracted attention during the present decade it was regarded as an apparition whose tolerance

was fraught with fearful consequences. There is no doubt that American banking and the American public will pay a price for greater banks. Under sympathetic treatment that price has lost its spectral and horrific qualities. We need go back only as far as 1923 to find a Comptroller of the Currency, Henry M. Dawes, vigorously defending the unit bank and assailing the pressure to expand through branches.

A Comptroller on the Consequences of Branch Banking

A submission to this pressure would be followed by grave consequences among which he enumerated, the emasculation of the Federal Reserve System, the disappearance of the unit bank and the creation of a banking monopoly. Mr. Dawes is no flannel-throated communist or trepid alarmist. The banking situation has not changed so far that the words uttered in 1923 are without validity in 1930. To the dangers of greater banking there is added the loss of those qualities which constitute the virtues of the small bank, the position of the unit banker in his community, his life-long identity with its needs and progress, his grasp of local factors, his willingness and ability to accommodate an applicant on strength of character and his freedom from the withering formalism of large scale banking Under the personal administration of the local banker banking is a profession. Under

the rigidly regulated administration of a branch manager banking is a large scale business.

Another Comptroller on the Consequences of Unit Banking

Six years after Mr. Dawes has spoken another Comptroller, J W. Pole, speaks forth. He sees in unit banking the cause of the thousands of bank failures which have afflicted our agricultural communities. He can see salvation only in large scale branch banking. The small bank, he avers, is unable to make reasonable profits and unless the present urge to consolidate and expand be granted freer play the current epidemic of bank failures must continue. He draws a sorry picture of the unit bank. We may summarize the case against it as follows:

The unit system of banking in agricultural sections is neither safe for the depositors, profitable for the stockholders or adequate for the borrowers. The great banks assure diversification of loans and investments, greater mobility of funds, greater uniformity of charges and superior security and trust service for the client. With their branches they emancipate the local borrower from the tyranny of the unit banker.

"What Is Truth?"

Examining the case for and against we are moved to press Pilate's interrogation, "What is

truth?" In our search for it we have leaned heavily upon the measurable statistical record of banking in this country and upon such evidence as the experience of Canada and England provide We occasionally reach elsewhere for light but there is always the danger that the conclusions will suffer from the dissimilarity of the conditions whence they are drawn.

Method of Gathering Evidence

For some years the Comptroller of the Currency has published the classified earnings and expenses of our national banks. Fortunately for our purpose the records of reserve city and country banks are given separately. It is possible, for example, to isolate the national banks of New York City, San Francisco and Los Angeles. In 1921, 45 banks reported from these three cities. In 1929 the number had fallen to 35. This group is dominated by eleven great banks which have an average capital and surplus exceeding $75,000,000. These mammoth institutions account for more than 92 per cent. of the capital funds of the entire group. Therefore, the income and expenditure characteristics of these great banks govern the returns for the group and those returns may be considered a true reflection of the income sheets of great banks. We shall refer to this group as the Big Bank Group.

Our second group consists of medium size city banks. It includes all the national banks in twenty cities selected from all parts of the country. We have here 113 banks with an average capital and surplus of approximately $2,500,000. It takes thirty of these banks to equal in size one of the eleven banks which dominate the first group. This group we shall call the Medium Bank Group.

Our third group comprises the country banks of eleven states where failures have been comparatively low during the last nine years. That the picture presented by this group is not purely sectional is indicated by the inclusion of all the country banks of such states as Maine, Virginia, Alabama, Kentucky, Nevada and California. The group contains 1340 banks with an average capital and surplus slightly in excess of $250,000. It takes 300 of these banks to equal one of the eleven banks which dominate the first group. These provide a portrait of the typical American country bank which has not been overwhelmed by community or occupational distress. It is the fate of this small bank which hangs in the balance. We shall refer to this group as the Small Bank Group.

Finally we have taken the surviving national banks in the twelve states where 70 per cent. of our bank failures have occurred during the past nine years. They number 2309 banks, have an average capital and surplus slightly exceeding $100,000

and seem to come predominantly from a few states in the South and that group known as the Central Northwest. The statistical diagnosis of this group reveals the ailments from which they are suffering.

Income and Expenditure Ratios

The following ratios have been calculated for each group for each of the nine years in the period 1921-1929:

I—Net Addition to Profits to Capital and Surplus

II—Interest on Deposits to Gross Earnings

III—Interest and Discount on Borrowed Money to Gross Earnings

IV—Salaries and Wages to Gross Earnings

V—Taxes to Gross Earnings

VI—Net Losses to Gross Earnings

VII—Interest Paid on Deposits to Interest and Discount Received

VIII—Net Additions to Profits to Gross Earnings

IX—Net Expenses to Gross Earnings—Operating Ratio

X—Interest and Discount Received to Gross Earnings

XI—Gross Earnings to Capital and Surplus —Turnover

XII—Loans and Discounts to Investments

Balance Sheet Ratios

Maintaining the same groups we have made a balance sheet analysis. This examination is more comprehensive because of the inclusion of the "Big Five" of England and the ten chartered banks of Canada. From the position statements of the British, Canadian and American banks five ratios have been calculated for 1929.

I Ratio of Total Deposits to Capital and Surplus

II Ratio of Total Deposits to Cash and Reserves

III Percentage Bank Premises to Capital and Surplus

IV Percentage Loans and Discounts to Total Deposits

V Percentage Investments to Total Deposits

This material helps us to answer many questions.

Is the great multiple bank safer than the small unit bank?

Is the small unit bank unable to make a fair profit?

What are the economies of large scale banking?

What are the profits of large scale banking?

What are the disadvantages of large scale banking?

Safety

We have selected the criterion of safety first because of the emphasis which the present Comptroller has astutely placed upon that element in his recent testimony before the Currency and Banking Committee of the House. Due to the complex of fears from which our legislators suffer it would be quite impossible to secure statutory consent to large scale banking since that invokes the apparition of monopoly. In the hands of a demagogic politician that danger—and an element of danger must be granted—becomes a horrendous threat to the health, safety and morals of the community. Congress will never sign the death warrant of the small bank unless it is persuaded that such a course will provide the only assurance of safety for the depositor. The bank failures cited by the Comptroller are truly impressive.

Big Banks No Guarantee Against Losses

A careful examination of all the evidence, including not only the experience of our own small banks but also the banking systems of other nations in which concentration has freely pursued its course fails to support the contentions of that official. "Believe it or not," the small banks in our third group have a better record for losses than the great banks in our first group. We shall see that the highly lauded Canadian banking system shows a

greater score of bank fatalities than our own decentralized unit system. As free as we are to grant the superior mental calibre and vision of the management which the great bank can employ as compared to that which directs the small bank we must note that safety is a function of prudence and not intellectual power. The ablest men are often more ardent devotees of the goddess of chance than their less scintillating brethren. The bank failures of post-war Italy, the difficulties of great banks in France, Germany, Japan and Canada indicate clearly that size is not the magic formula of safety.

Profits

Nor need the small bank yield to the charge that it is unable to compete with the great bank on the basis of profits. The banks in our first group show a better and perhaps more consistent record of profits than the country banks in our third group—as a whole. There are significant exceptions. The returns from San Francisco which are dominated by a great bank with 292 branches show a ratio of net profits to capital and surplus which is exceeded by most of our small banks. The country banks of Maine and New Jersey show profits distinctly above those of the large banks in New York City. If large scale banking is to justify itself to the stockholder it must do so in the future on the basis of economies now

being realized and sources of profit now being exploited.

Economies of Large Scale Banking

The large bank we find pays out less of its gross earnings in the form of salaries and wages than the small bank. This statement must be qualified by the exclusion of the branch systems of California. The economies realized in this way by the banks of New York City are not shared by the banks of Los Angeles and San Francisco.

All the large banks seem to have a definite advantage in the allotment of earnings for taxes. This is quite substantial, amounting to approximately 2.5 per cent. of gross earnings in favor of the large banks as compared to the banks in our other groups.

The large banks spend less of their gross earnings in the conduct of their business than the banks in the other groups. To put it differently they have a lower operating ratio. Here again the conclusion is forced by the New York City banks. The branch systems of California appear at no advantage whatsoever as compared to the banks in the second and third groups.

The banks in the first group possess a definite advantage in the diversity of the business from which they derive their earnings. Where the smaller banks receive more than 90 per cent. of

their income from the classic banking functions of lending and investing the large banks get less than 80 per cent from these sources. To a steadily increasing extent they are reaping profits from business which integration has brought, trust services, the sale of securities, insurance and foreign exchange commissions. In subsequent chapters a more detailed examination will be undertaken.

Banking Changes and the Federal Reserve System

The changes now taking place in American banking will have a profound effect upon the place occupied by the Federal Reserve System The great multiple banks may in time become entirely independent of the Reserve Banks and may be able to nullify the efforts of the central bank to control credit. This need not be an unmixed evil. The small unit banks will probably be driven in increasing numbers into the arms of the system through the stark necessity of self-preservation.

Promises versus Threats

In conclusion at this time we may say that the changes in our banking structure now impending bear many promises and some threats. To this student at least, the promises which the current literature on the subject outlines appear exaggerated. Intelligent and conservative management of the greater institutions now in process of devel-

opment may modify the losses to American community life which the current changes in American banking seem destined to exact.

CHAPTER II

Banks and the Merger Procession

Another merger. The headlines become monotonous. Yet they remain headlines. They bespeak the conviction of our newspaper editors that the centripetal tendency of enterprise is a matter of vital public interest. They also suggest to the uninformed that the movement is novel, another revolution, as it were, in the domain of economics.

Insofar as headline prominence is a true reflection of public importance, it is proper—nay, almost necessary—for the economist to bring his trained judgment to bear upon the phenomenon. The implication of revolutionary change resident in such persistent press attention must be denied.

Merger Movement Not Novel

The merger movement of today, while proceeding at a relatively intense pace is in no sense a generic departure from previous economic progress. It has characterized man's effort since his first feeble struggles in the historic dawn of economic life. The collosal mergers of today are merely the triumph of the principle of cooperation. No animal

has been in a better position than man to appreciate the futility of individual isolation and the boon of team-work. The merger movement started when two men first discovered that they could build better together than separately. We do not here propose to traverse the ancient trail or to repeat the tedious, if important, details of the advance. Suffice it to say that movement has honorable and prodigious ancestry. Its pedigree reaches back beyond the horizon of time, hoary with age and sanctified by the cumulative material elevation of its beneficiaries.

Lag of Banking Growth

During the first quarter of the present century, our banks made no more progress in greater co-operation than agriculture or the legal and medical professions. There has, it is true, been an apparent growth in the size of individual banks during the period 1900-1925 from an average aggregate of resources of $104,000 (approximate figure) to $215,000. The dollar, however, is a fallacious and errant yardstick for measuring growth. The monetary unit in which banking size was recorded in 1900 was a far greater unit than that employed in 1925. If we subject our figures for size to the deflating process,[1] so that we employ a yardstick of equal size in both cases, we find that our banks

[1] Using Index of Retail Prices of Bureau of Labor Statistics.

have actually declined about four per cent. during this period.[2]

We are accustomed to think of our farms as stationary, and the figures support the opinion. The size of the average farm in 1900 was 146 acres and in 1925 145 acres.[3] Turning to our factories we find (on the basis of the horsepower consumed) that they are four times as big in the latter year as in the former[4] while our steel mills and blast furnaces have grown five fold during the same period.[5]

Although our banks have been marking time as compared to other forms of enterprise in this country as well as banks in other countries up to 1925[6] they have during the past few years been making strenuous efforts to catch up with the procession.

Are Banks Suited to Growth?

The student may well ask at this point if the selective character of American economic progress is not after all sound. Is there not a definite reason for the failure of the banks to keep step with the other units in the march? Does it follow that banking is capable of sharing in the rewards

[2] *Annual Reports of Comptroller of Currency,* 1900, 1925
[3] *Statistical Abstract of the U S*
[4] Bureau of the Census.
[5] *Ibid*
[6] See Willis and Beckhart, *Foreign Banking Systems,* pp 326, 340, 1242, 1243.

of improvement resulting from combination, merely because the physical industries have demonstrated such a profit? Is it not a fact that banking, subsisting as it does on the sale of a highly personal service, is as little suited to large scale administration as medicine or law?

Little Analogy Between Bank and Industrial Growth

A consideration of some of the benefits which presumably flow from giganticism in other fields gives point to these questions and establishes the fundamentally distinct character of the banking business. The author confesses that his initial interest in the whole subject of bank consolidations was due to his inability as an economist to discern in this movement any of those advantages which combination in other fields promised, promises which have in a measure been fully justified by subsequent experience.

To emphasize the distinction of the banking prospect as contrasted to the industrial prospect in the face of combination, let us return to the opening of the century and take the witness stand before the Industrial Commission with the advocates of bigger business.[7] It must be remembered that this testimony is given at a time when the public is aroused by the fear of conscienceless monopoly. The revelations of crime, corruption and coercion,

[7] U S Industrial Commission, *Report of the Industrial Commission*, Vols 1, 13 1900, 1902

the Faustian price of progress,[8] were sordid and alarming. The prevalent and ill concealed impulses of our industrial buccaneers to damn the public and disavow all responsibility to the community placed big business in an unfavorable light. The leaders who were called upon to justify their Gargantuan creations extolled and exaggerated many virtues of large scale production which were plausible, if not obvious, and remained discreetly silent about defects and perils strongly suspected by a trepid public. The point is that they made a good case on economic grounds for greater units.

It is not to be assumed that banking today dwells under any equal necessity for justifying its desire for cooperation. Except in the fevered minds of certain political Lochinvars, the banks of the country are under no suspicion of exploitation inimical to the public weal. Part of that is due to an intelligent perception of the public trust confided in them and part also to the rigid measures of governmental supervision.

Economic Brief of Big Business

When big business on the occasion mentioned above filed its brief, it rang all the familiar changes on the economies of large scale enterprise. How impossible it is to establish a similar case for banking is easily demonstrable.

[8] Lloyd, Henry Demarest, *Wealth and Commonwealth.*

Economies in Purchase of Raw Materials

A large industrial unit can realize economies in purchasing not open to the smaller unit The largest buyer presumably is always the most favored buyer. Is there any analogous advantage in the banking field? Deposits are the principal raw material in the banking business. Does the size of the bank establish it in a favored position in the payment of interest rates? The situation on the contrary is very often reversed with the large institutions offering better rates on deposits than their smaller competitors. Although it is quite generally the practice of city banks to pay interest on demand accounts above a certain minimum, this is less generally true of country banks There are exceptions, of course, in both cases. Furthermore size imposes a very definite discrimination against the large banks. Under our state banking codes as well as under the Federal Reserve Act the ratio of necessary reserves to deposit liabilities varies with the size of the community in which the bank functions. The First National Bank of New York City, for example, must maintain a reserve of $13 against every $100 of demand deposits, whereas, the First National Bank of Princeton must maintain only $7 against a corresponding liability.[9] Insofar as the costs of the "raw materials" of bank-

[9] This difference is modified to some extent in favor of the large bank by the reduced cash necessary in view of proximity to a Federal Reserve Bank

ing go, it is almost correct to say that they vary inversely with the size of the institution. There may be some slight economy in the purchase of fuel, stationery and office equipment, but that, after all, is an infinitesimal part of the total costs of banking.

Distribution

A field in which industrial units have made much progress and in which there is still ample room for improvement is distribution. Middlemen and jobbers have been eliminated and the costs of distribution reduced. This has been accomplished partly through integration and partly through voluntary agreement among competitors. Such economies are hardly possible in the banking business. To a very limited extent, there is an organization for distribution in the banking field corresponding to that in industry, *e. g.* in the sale of commercial paper and acceptances, transactions involving foreign exchange and the sale of securities. In the great bulk of bank business, *i e* the sale of credit to clients, there is no more opportunity to curtail costs of distribution than there is in the sale of legal advice. There are no middlemen or jobbers to displace.

Transportation

Large scale enterprise is also in a position to negotiate more effectively with transportation

agencies. At one time this resulted in marked favors from the railroads. Although this has been largely eliminated, big business is still in a much better bargaining position in the purchase of trucking service or in the establishment of such a service as an integral part of its own productive process. Our chain stores have effected substantial economies by the construction of warehouses at strategic distributing points and the elimination of excessive hauls and overlapping transportation. How are such economies open to banking? Credit is an imponderable substance. In the physical sense, it presents no distribution problems. By the same token, no economies analogous to those in other fields are possible. True, the establishment of the Federal Reserve System has eliminated much unnecessary transportation of currency and gold, but the consequent advantages accrue to all banks, large or small, with or without branches.

Efficient Plants and Continuous Operation

The great producing units in the industrial field have been able to realize substantial benefits in the elimination of inefficient plants and the concentration of production in the best equipped and most efficient units. The American Sugar Refining Company at one time concentrated its production in five refineries and dismantled the many plants

of its competitors, acquired throughout a period of melodramatic consolidation. We have the same phenomenon today in the consolidation of power plants. Wherever possible, greater producing units try to operate continuously. Such a procedure is obviously not open to banks. The large bank cannot use its plant more completely or more continuously than the small bank.

Specialization

Nor can the specialization of plant, machinery and production technique extended to such amazing refinements in the industrial field be applied in banking. The granting of a loan cannot be broken into five hundred separate steps by motion studies. Conveyor belts are of no value whatsoever in assembling the various ends of a banking transaction. Nor can employees' output be stimulated by bonus plans or piece work payment. The mechanical genius which finds in physical industry a rich field for its explorations finds little reward in banking. There has been an amazing improvement in recording and tabulating devices and in a host of appliances which increase clerical efficiency and add to the convenience and value of the service which banks can offer their clients, but the fact remains that these are as available to the small bank as to the large.

Banking Function Not Susceptible to Factory Methods

The salient and peculiar trait of banking is the intensely qualitative character of the service which it dispenses. The granting of a loan and the purchase of a security call for fine discernment and balanced, informed judgment. Formal rules may offer some slight help and offer the banker a rough guide, but they supplement rather than displace those manifestations of intelligence and skill which constitute the essence of the banking function. On the part of the client, his appeal to the banker involves the exchange of confidence and a mutual and subjective appraisal of character as well as a consequent adaptation of the two principals to each other. Such relationships are not susceptible to factory methods. The business man applying for accommodation is disinclined to unburden himself to an automaton and the latter, even though human, is very often incapable of providing that intelligent, comprehending and sympathetic reaction which the client demands in such an intimate service. Banking on a large scale, as we shall see later, offers certain definite advantages which recommend themselves to the lay mind as well as to the sophisticated judgment of the financier and economist. We wish at this point to indicate merely that industrial consolidation and growth casts but a feeble and misleading light on

the underlying motives of the amalgamation movement in banking.

Bigger Business, Bigger Banks Hypothesis

Nor can we accept the widely circulated notion that large banks are the homeopathic concomitants of larger business units. That bigger banks are the natural response to bigger business is a plausible hypothesis, but only that. One wonders how many banks are driven into each other's arms because they have suddenly discovered that they cannot accommodate their powerful clients. In how many cases are the negotiators actuated by the fear that a failure to consolidate will render them impotent in meeting the demands of heavy borrowers? There are two excellent reasons which militate against the acceptance of this hypothesis.

Large Banks a Doubtful Boon to the Business Man

In the first place, the puissant bank client in America, be he an individual or a corporation, does not maintain all his deposits in a single bank nor, by the same token, does he seek assistance when needed from one institution. For years, since the memory of man recalleth not the contrary, it has been the practice of heavy borrowers as well as heavy depositors to divide their accounts. On the part of the depositor, it has been the result of a

prudent desire to distribute his risk. Although banks as legal entities possess immortal qualities, as practical going concerns, they are subject to many hazards which may terminate their existence. Frequent mortality is unfortunately a characteristic of American banking which the experience of the past nine years has emphasized.

Dividing Accounts

The borrower in distributing his applications for accommodation is motivated by caution of another sort. He does not care to disclose his business or speculative commitments too fully even to his banker. By distributing his dependence among a number of institutions, he is given greater latitude and can camouflage his movements more effectively. Furthermore, he can secure more accommodation on the basis of a given credit rating by dealing with a number of banks than by confining his appeals to a single bank. Banks do not maintain clearing houses of information relating to credit extended to their clients. Under the American system of divided dependence, the ambitious entrepreneur has a freedom and enjoys a flexibility of movement which he would be very reluctant to surrender. It enables him for example to use substantial quantities of credit in his business as part of his permanent capital. True, most banks expect their clients to clear their accounts

at least once a year for a brief period. If a man's line of credit leads into a number of institutions, it is a simple matter for him to borrow from one bank to pay off a loan at another. So thoroughly aware of this practice are American bankers that they are not above suggesting to clients that they might borrow funds from another bank for the thirty or sixty day period necessary to purify their accounts of the taint of permanent borrowing.

When Two Plus Two Does Not Equal Four

An interesting corroboration of this point is supplied by the discovery of certain banks after a merger had been consummated that the deposits of the new institution were not equal to the sum of the deposits of the two constituent members. Clients which formerly had deposits in both institutions now sought another bank to replace the one which had disappeared in the merger process. Apparently the capacity of the new institution to take care of bigger business was esteemed by such clients as something less than a virtue.

Using the Stock Market Instead of the Bank

The second major reason for the failure of the bigger-business-bigger-banks hypothesis to hold water is the fact that large scale as well as moderately sized enterprise has in recent years gone increasingly to the stock market for its capital

requirements. The prolonged bull market terminating in October and November of 1929 appealed to the dormant speculative instincts of the American people. The prospect of tapping a mundane pot of gold was actually realized in so many cases that thousands of capital roads were diverted to Wall Street which had formerly found termini elsewhere. The inherent attractions of the common stock were exploited in effective and at times dramatic style. The theory of diversification and safety, of appreciation, of participation in the growth of a vigorous and fabulously rich country was expounded in a thousand different attractive forms. Investment was treated increasingly as a "science" revolving preponderantly about common stocks as its media. It became a field, at least according to its prolific literature, governed by precise formulae in which definite and ascertainable cause was followed inexorably by predictable effects. "You, too, may become rich" spread across the advertising pages of a host of respectable periodicals. This remarkable discernment (if you did not have it yourself, you could buy it) was the unfailing beacon light to wealth, culture and the privilege of paying an income tax. The magic qualities of common stocks proved an irresistible magnet for all forms of capital and luxuriant clover for those who needed it. Consequently, many clients who had wearied of chronic genu-

flections before banking altars seized the opportunity for emancipation. Additional stock was issued and sold to an eager public which paid scant attention to income and much attention to appreciation.

Although many investors of the new school lost their shirts during the tragic days of October and November, 1929, the speculative ardor has not been quenched. At the time of writing (February, 1930) the market had registered substantial if unheralded recovery from its lowest depths, customers rooms in brokerage houses again responded to the thrum of animated occupants and the turnover of stocks indicated anything but a placid functioning of the investment process. Aside from the regretable speculative excesses which attended the recently interred bull market, common stocks have made a definite gain in public esteem which will assure the meritorious enterprise of the future a degree of capital support which it could not have realized in an earlier day. With that support comes a release of the heavy borrower from bank dependence which goes far to deprive the bigger business-bigger banks theory of validity.

Big Business Should Have Given Us Big Banks Long Ago

Finally, if the greater scale on which we transact business today is a fundamental factor in bank growth, its influence should have been manifest

long ere this. As we pointed out at the beginning of this chapter, the movement toward greater units is not new. The first quarter of the present century witnessed prodigious changes in all the physically productive and distributive fields except agriculture. Is there any sound reason for deferred effect on banking? Why has the response of banking been postponed to this late day if the causes have been operating throughout a quarter of a century? This anomalous suspense of sympathetic growth has not been explained and we look in vain for the sustained impotence and sterility of this putative cause.

We have so far been considering merely the superficial assumption that bigger business needs bigger banks. It would hardly be correct to deny all connection between the two as cause and effect.

Wherein Great Banks Are an Aid to Big Business

Greater banks, largely because of their greater size and superior facilities, can appeal to a powerful business clientele in a manner not possible for the small old fashioned unit bank. Practically all the large banks now have functions which some years ago were considered outside the pale of ordinary banking enterprise. They have correspondent or direct connections with powerful financial institutions abroad. In a few instances they have their own branches in alien lands in which the outposts

of American trade have been established. The services which such banks can offer make a strong appeal for the patronage of the American who is unable or reluctant to make engagements with foreign institutions. It is but natural that such service should be an excellent feeder for the banks' normal business of deposit and discount.

Security Distribution

In the field of security distribution, there is likewise a distinct causal connection between big business and big banking. Most of our large banks are closely affiliated with security companies. We have previously noted the increasing tendency of corporations to seek financial support in the stock market instead of from the banks. Even so, they require the aid of the very institutions from which they wish liberation. The ability to provide immediate and wide distribution for securities at the best market price, with assured support of the market until they have found their way into the strong boxes of investors, is not the least of the superior facilities with which the great bank attracts the business of a great corporation.

Strength and Prestige

Finally, there is the element of strength and prestige which the larger bank can offer. Even if we grant no superiority in management, the bank

with $25,000,000 in resources is far stronger than a hundred banks each having $250,000 in resources. It is the old principle of strength in union. As a depositor, the important client feels a greater sense of security in the large bank. While the big institution may be more exacting as a creditor, more insistent upon a cold and formal and thorough analysis of the applicant's capacity to repay a loan, it undoubtedly holds forth compensating attractions in safety. We shall examine at a later point the relative safety of systems of large banks and systems of small unit banks.

Growth a Reflection of Change in Character Rather Than Size

We may note here that two of the three sympathetic bonds between big business and big banks, *i. e.* foreign banking service and security distribution, are recent developments in American banking. They reflect a change in the character of American trade and enterprise rather than an increase in size. In other words, our banks have developed their foreign service not because business is big, but because it is increasing its foreign contacts. Nor have they gone into security distribution because our business units are bigger. It is merely the adaptation of the bank to a new method of corporate financing resting in turn upon an increase in the size and capacity of the investing public.

A word should be said about the character of the evolutionary process in banking. It must not be supposed that branch banking is the only, or principal, manifestation of bank growth. An approximate analogy between the form of growth of banking and productive and distributive enterprise is possible. In the latter fields, we have become accustomed to the analysis of growth which distinguishes vertical and horizontal development The same analysis may be applied to banking.

Growth by Integration

The great bank reaches back to the sources of credit through its appeal to the current and savings depositor. In this respect it possesses no advantage over the small bank. In its requisition of reserves, it is no better and perhaps not as well off as the small bank. The central fund of credit held by the Federal reserve banks is as accessible to the small as to the large bank However, it is in the control of the disposition of this credit that we see signs of integration and a definite advantage over the small bank. The departure from traditional commercial banking is so definite and the operation of savings, commercial and trust departments by the same institution so common that we cannot point to these evidences of integration as peculiar advantages of large scale banking. In the distribution of securities, the underwriting and sale of

insurance and the financing of foreign trade, large scale banking is able to conserve its credit in a manner not yet open to the small bank.

Object of Integration

The object of bank integration is two fold, to earn the commission for the extra service and secure the maximum retention of the bank's credit.

The latter object requires explanation. If all the depositors of a bank demanded payment at the same time, the bank would be ruined. If none demanded payment or if one depositor drew upon the bank only to pay another, the bank could realize the maximum profit from its credit. The object of integration is to control the flow of payments of depositors into the accounts of other depositors. The methods by which this is accomplished and the incidence of the benefits will be traced more fully in the chapter on the profits of large scale banking.

Horizontal Growth

Horizontal growth in banking may take place through an expansion of existing facilities in a single place of business, through chain and group affiliations or branches. The first form of expansion is illustrated in the First National Bank of New York. This institution belongs in our group of great banks, although it has no branches or

subordinate members. The connection between a group or chain of banks may take any one of a number of forms. The Economic Policy Commission of the American Bankers Association has defined three distinct types of unified control in this field. In the first group a single bank exercises definite control over the group; in the second, a holding company provides the unity, while in the third class, singleness of purpose is provided by an individual or a group of individuals.[10] This classification is instructive, but not exhaustive, for there are many border line cases and some that cannot be placed in any one of these three groups. The third form of horizontal growth is through branches. These may be established *de novo* or represent the conversion of former independent banks. Of the 3,440 branches in this country on June 30, 1929, 2,329 were established *de novo,* 958 by purchase of banks, while the remaining 153 have not been classified.[11]

That is the warp and the woof of the evolutionary procession in banking.

[10] *American Bankers Association Journal,* October, 1929 p 4
[11] *Federal Reserve Bulletin,* December, 1929 p 766

CHAPTER III

GREATER BANKS AND THE AMERICAN TRADITION

THE FAILURE of American banks, as a whole, to achieve that great stature which distinguishes the banks of Canada, Great Britain, Germany and France, not to mention other nations which belong to the second or more remote order of industrial and economic prominence, is a matter for question. Certainly no fault can be found with the enterprise of the American. In all other fields he has seized avidly upon every promise of profit and exploited it intensely and relentlessly. Our amazing material progress has provoked the interest, admiration and envy of the old world. Expert commissions of inquiry have been sent to our shores to reveal the mysterious origin of our prolific fount of income. While noting such material factors as prodigious and apparently inexhaustible natural resources, the blessings of a vast domestic market unhampered by tariffs and the consequent practicability of large scale production, they have also paid unstinted tribute to that aggressive energy of the American people which constitutes the driving fuel of effective enterprise. Entrepreneurial anemia is certainly not the explanation of our failure

to bring forth offspring in the field of banking comparable in size and number to those in other fields.

Some Great Banks

There are exceptions, of course. New York abounds in banking houses of the first rank, not only in integrity and perfection of service, but in size as well. In a number of other cities banks have been approaching proportions which permit comparison with the great banks of other nations. However, these banks are confined to the great cities. Throughout the length and breadth of the land, the small unit bank overwhelmingly dominates the banking stage. It should be added that this is true only of numbers and not of resources. On June 30, 1929, there were 25,115 banks in this country, of which 818 [1] were operating one or more branches, while 1,784 others were members of 272 chains.[2] Thus, in point of numbers, the unit banks still hold the field. However, our ten largest banks, constituting but 4/100 per cent. of the total number, held approximately 15 per cent. of the banking resources of the country.[3] One per cent. of our banks hold a trifle more than 46 per cent. of the resources of all our banks,[4] and about three quar-

[1] *Federal Reserve Bulletin*, Dec, 1929, p 768
[2] *American Bankers Association Journal*, Oct 1929, p 4
[3] *Ibid* p 2
[4] *Report of the Comptroller of the Currency*, 1929.

ters of the nation's commercial deposits.[5] The resources of the 272 chains aggregate $12,500,550,000, and are equal to about 17 per cent. of our total banking resources.[6] Our chains, plus our 250 largest banks, slightly exceeding in number 2 per cent. of our banks, control 63 per cent. of the nation's banking sinews. According to all appearances, the momentum of the movement is still in process of acceleration. Whatever may be said of the comparative stagnation of banking developments in this country during the first quarter of the present century, the banks at present seem determined to make up for lost time.

"The Genius of the American People"

It is the pace of this movement as well as its destination and the effect of its precipitate rate which is arousing concern. Many sincere friends of unit banking, as well as a number of alarmists who see sinister omens in all forms of concentration, have asserted that the trend is a violent and unwholesome reversal of the historic emphasis upon American individualism and contrary to that flatulent illusion "the genius of the American people."

A Fair and Competent Statement

Perhaps the fairest statement of this view comes from George W. Davison, president of the Cen-

[5] *American Bankers Association Journal, op cit* p 2
[6] *Ibid* p 4

tral Hanover Bank and Trust Company of New York. We might go west of the Mississippi for a more colorful exposition of this view or to Washington for a case breathing ardent solicitude for the common people. Mr. Davison is much better.

"In no phase of our American life, has our individualistic tradition maintained so thoroughly the free play of competition as among our banks. It is that which is primarily responsible for the adaptability shown by the American banker to all the changing needs of new conditions and the promise of new opportunity."

"The implications of an answer in favor of an intense concentration of control in the banking field must cause still more concern because of the basic characteristics of American banking in its historic past, and because of the contribution of banking to the exploitation of American economic resources and the prosperous growth of American enterprise.

"When we recall, and recall we can with pride, the encouragement and assistance which the freedom of independent initiative in our highly individualized banking system has given to the constructive achievements of American history and trade, and the enhancement of the popular welfare, I am satisfied that all these questions can receive an answer affirming that there is no necessity in our banking past or present for a revolutionary change

in our banking system in the near or further future."[7]

Two Ideas

These quotations carry two ideas. The first is the conviction that there are innate susceptibilities in the soul of the American race which are at odds with the forces of concentration in banking. The latter, in other words, is incompatible with that vague spiritual complex of the race, that cumulative force of tradition and generic idiosyncrasies which political historians flatteringly define in terms of genius. The second idea is that independent unit banking has supplied a measure of sympathetic response to the enterprising aspirations of the American people incomparably superior to that which any other banking system could have provided. Unit banking has been to American enterprise what a perfect mate is to a man. The latter might have made the grade with some other daughter of Eve, whose beneficent inspiration and understanding ministration were less than perfect. Never would he have been able to point to the stupendous feats of achievement which constitute the illustrious record of American progress.

The Art of Looking Backward

This second point we shall consider more fully at a later stage of this study. We are here inter-

[7] *Ibid* p. 8, 9.

ested in the banking manifestations of American genius. Before designating any peculiarity of the American character as immutable and cast for all time in the inflexible mold of history, it is well to look back. In considering the evolution of American banking, it may be that we fail to look back far enough.

Pre-Civil War Regulation of Banking

Aside from the two adventures into central banking, the federal government paid scant attention to commercial banking. True, its policies were often weighted with significance for the banks of the country as, for example, Jackson's specie circular and the ever recurring and controversial problem of government depositaries. No legal enactments emanating from Washington attempted the regulation of our banks prior to the passage of the National Banking Act. They were left to the tolerant mercies of the state governments. So baffling were the problems of banking, so great the abuses, so impoverished in judgment and experience our state legislators and so chronically futile their efforts at solution that a number of states found in the absolute prohibition of all banking the only satisfactory surcease from its manifold ills.[8]

[8] Michigan and Wisconsin, Horace White, *Money and Banking*, 2nd edition p 362 In the debate on the National Banking Act, Senator Henderson demanded that every bank in the country be blotted out of existence *Congressional Globe*, Feb 10, 1863, p 851.

Under the diverse regulation of the states many types of banking developed Branch banking was prevalent but was gradually rooted out in the North and concentrated in the South. The extent of branch banking and its declining importance may be judged from the following table:

State Banks and Branches in the United States
1824-1858

Year	Number of Banks	Number of Branches
1834	406	100
1835	558	146
1836	567	146
1837	634	154
1838	663	166
1839	662	178
1840	722	179
1841	619	165
1842	563	129
1843	577	114
1844	578	118
1845	580	127
1846	587	120
1847	591	124
1848	622	129
1849	654	128
1850	685	139
1851	731	148
1854	1,059	149
1855	1,163	144
1856	1,255	143
1857	1,283	133
1858	1,284	138

The figures for 1852, 1853 are omitted because incomplete
Report of the Secretary of the Treasury, June 30, 1858 pp. 358, 360

It will be seen that the relative importance of branches declined from a position where one banking office in every six was a branch to a position where only one office in ten was a branch.

In view of the persistent advocacy of branch banking as an antidote for the banking disorders of the day, particularly with reference to failures and losses to depositors, it may be of interest to know why it declined at a time when the profusion of banking disorders could provide an exacting test of its *therapeutic* qualities.

Branch Organization and Bank Abuses

A consideration of the evidence discloses that branch banking, far from mitigating the grave afflictions borne by the banking system of the day, appeared to be the medium through which they were aggravated. Let us turn to the patient and see how branch banking impaired his resistance to the diseases of abominable banking.

In every community and at all times there are men with schemes of enterprise which fail to win banking support. Rarely do the rejected applicants accept that failure as evidence of flaws in their projects. On the contrary, such refusal is usually seen as an expression of discrimination, imperfect judgment or plain stupidity on the part of the banker. The decades prior to the Civil War had their fair share of business adventurers. They

were the guiding spirits of the legion of fly-by-night banks which gave that era an unsavory repute.

An Era of Speculative Don Juans

Banks were often established not because there was capital in the community seeking investment, but rather because certain speculative Don Juans were unable to obtain accommodation from banks having real capital and established reputations.[9] It may be somewhat of a mystery to the lay reader in the year of grace, 1930, how a group of impecunious adventurers can organize a bank and lend themselves the money which a reputable institution will not grant. The process was simple. The group met with all the solemn hocus pocus of legal formality. Each member received an allotted number of shares of stock. Incantations were read. The child was born. How did the shareholders pay for their shares when, according to the premise, they had no money? With the first breath of corporate existence, these gentlemen applied to the bank for a loan, offering the stock of the bank as security. Crudely engraved notes were printed. The privileged applicants were honored with loans. Said applicants, who were also stockholders, be it remembered, passed back the bank notes in full payment of their stock. The capital of the bank is paid up. Is it any wonder that the people of such

[9] *The Report of the Secretary of the Treasury*, Feb. 24, 1820.

an age should seriously court the phantasy of perpetual motion or fail to understand their inability to lift themselves up by their bootstraps? Emerging from such a disreputable matrix, a bank would attract only such clients as had everything to gain and nothing to lose. The bona fide borrower or depositor had to exercise great caution and was constantly admonished by the tragic experiences of his countrymen in other communities.

Personal Vigilance the Only Assurance of Safety

He had a frail defence in the law which in its own maladroit and doddering fashion tried to correct abuses. The citizen soon learned a safer remedy. He carefully scrutinized the character of the men who founded the institution and kept their activities under his constant surveillance. If they were men of substance, honest and conservative, the bank could be trusted. It was difficult, if not impossible, to appraise the character of men in distant parts. They could not be observed. Hence, the insistence upon local owners and local managers of a bank. Branch banking impeded that alert vigilance which the wary citizen found necessary in his banking relations.

Keeping the Bankers at Home

In practically all the northern states we find the ownership of stock restricted to citizens of the com-

munity served by the bank. This was due partly to jealousy, but chiefly to a desire to keep an eye on the stockholders. It is for this reason that the Governor of the State of New Hampshire in 1841 urges legislation to prevent the control of banks from passing into the hands of outsiders.[10] In the same year, the Commissioners of Massachusetts declared that non-resident control had proved ruinous in every case.[11] In 1854, the Superintendent of the Bank Department of New York reported that every bank which had failed during the previous eight years had been owned by non-resident brokers and speculators.[12]

In most states the law required the residence of the bank director in the state. Sometimes the county was prescribed, and in Massachusetts (after 1853) residence was confined to a radius of ten miles from the bank.[13] The thirteen directors of the Girard Bank had to be residents of the city or county of Philadelphia.[14] Such restrictions, imposed for the sake of safety, were hardly compatible with branch banking.

After the glaring abuses in the formation of banks had been detected and legislation passed to curb them, branch relationships and other affilia-

[10] Dewey, Davis R *State Banking Before the Civil War.* National Monetary Commission, p. 25.
[11] *Idem*
[12] *Ibid* p 27
[13] *Ibid* p 122
[14] *Ibid* p. 123

tions enabled the banks to evade them. Where the state code calls for specie payments of capital, compliance with the law is greatly facilitated if a group of banks can cooperate in the establishment of the common specie fund which will serve as the "initial capital" of each member of the group.[15]

Currency Disorders

More productive of distress than the phantom capital of the banks was their note distributing proclivities. It was a day in which checks were not commonly used and deposit credit could be circulated only through bank notes. The greater the quantity of its own notes which a bank could keep in circulation, the greater its profits. These notes were, in effect, circulating checks, and it was to the interest of the banks to render their presentation for payment as difficult and infrequent as possible. Branch banks fitted the need perfectly. Notes were paid out by the parent bank in the city which had been issued by an inaccessible branch in the hinterland. Each branch issued the notes of other remote branches. The arrangement was extremely attractive—for the stockholders. This was true in Kentucky, Virginia and rather generally throughout the South.[16] The looseness made possible by branch banking led to grave abuses and inflation in

[15] *Ibid* p 11
[16] *Ibid* p 108

Alabama.[17] Because of the greater latitude which branch banking offered the unscrupulous promoter, the laws of the northern states generally frowned upon branches and resorted to summary measures to repress evasions.[18] When certain bankers in New York loaned notes issued at interior towns and then, due to the difficulty of redemption at the place of issue, redeemed them in New York at a discount, the legislature stepped in and prohibited banking business at any place other than the actual residence of the banker.[19] For the same reason, chain banking was very popular with the slippery gentry who wished to maximize their outstanding credit. Georgia and Chicago were a favorite team, the bank in Chicago, paying out the notes of the bank in Georgia which very considerately reciprocated.[20]

Branch Banking Identified with Vicious Banking

It can readily be seen that branch banks were an ideal instrument for the aggravation of the currency ills of the time. Every history of banking dwells upon the distress caused by the thousands of notes circulating at varying rates of discount and heavily diluted with counterfeits and the notes of defunct banks. So embittered were the victims

[17] *Ibid.* p 138
[18] Breckenridge, R M *Sound Currency*, pp 6, 8
[19] White, Horace, *op cit* p 338
[20] *Ibid* p 354, 355

that many of them gave way to anti-bank phobia. Branch banking was considered one of the stigmata of a vicious and fraudulent banking system.

Hamilton regarded branches with some doubt. He felt that they introduced an unnecessary complexity to the system. The latitude which in the absence of ready communication must be granted to subordinates was a source of danger to the parent bank. In 1793 the Bank of Pennsylvania established several branches. When the legislature made the parent bank responsible for the notes of the branches, these were promptly closed.[21]

Worst Excesses in Branch Areas

There is little evidence that the branch structure where it prevailed had any stabilizing effect upon banking. In fact the South in which it was concentrated had by far the worst banks in the country. Failures were numerous. For 1839 Sumner reports 343 failed banks out of a total of 850 in the country. If we add 62 others which closed but subsequently reopened we have a little less than one half the banks in a state of insolvency.[22] The reckless speculation in lands, commodities and public improvements in which the banks were directly and indirectly involved resulted in an epidemic of failures which has had no counterpart in American

[21] *State Banking Before Civil War, op cit* p 137
[22] Sumner, William J *A History of American Currency* p 152

Banking history until the decade 1920-1930. Today we attribute excessive banking mortality to our small unit banks [23] and urge branch banking as a cure.

In the earlier period we damned the branch banks and held that small unit banking with stockholders and managers residents of the community which they served was one of the essential safeguards of sound banking. May we raise a small voice at this point and ask what historical tradition and the genius of the American people contribute to the problem of banking concentration?

Branch Banking Without Friends

Professor Southworth confesses some mystification at his inability to discover in the Congressional debates preceding the passage of the National Banking Act any reference to branch banking.[24] It is a reasonable conclusion that branch banking had so thoroughly discredited itself as the instrument of fraud and disorder that no voice could be found with the temerity to speak up for it. It was known that Secretary Chase had a profound distrust for state banks. One of the principle, if not the principle, reasons for the establishment of a system of national banks was the necessity of emancipating the country from the polyglot and

[23] *Report of Comptroller of Curerncy*, 1931, pp 2, 5

[24] Southworth, S D *Branch Banking in the United States*, pp 10, 11

crazy-quilt currency of the state banks. The defects of state banking were carefully canvassed and weighed. The new banking code embodied a determination to eliminate them effectively and permanently.

Source of Restrictions in National Bank Act

Many of the restrictions in the National Bank Act find their origin in the abuses of state banking in the era preceding the Civil War. We have mentioned the fact that many of the banks speculated directly in lands and goods and that their downfall was the consequence. The heavy cotton speculation of Nicholas Biddle was a major factor in the failure of the United States Bank of Pennsylvania in 1841.[25] The Western banks in general were overloaded with stocks and paid the penalty in failures. As a group, one-half their capital was so invested in contrast to 2 per cent. for the New England banks [26] In the South, banks were deliberately organized for the benefit improvement companies We have the example of the Central Railroad and the Georgia Railroad which were unable to raise capital and therefore secured charters as the Central Railroad and Banking Company, and the Georgia Railroad and Banking Company. The first railroad corporation in Texas was known as

[25] Hepburn, A Barton, *A History of Currency in the United States*, 1915 p. 140

[26] *Ibid*

the Texas Railroad Navigation and Banking Company. These "railroads" in many cases got no further than their plans, and when the crash of 1837 came, vast systems of ethereal railroads and real banks collapsed.[27] The lesson was not lost on the Congress which sought to establish a system of sound banks. When the banking malefactors were lined up in the prison courtyard at sunrise, branch banking was in the lot.

Caution as to Conclusion

It is only fair to indicate at this point that branch banking *per se* was not an evil. The abuses from which banking then suffered found in the branch organization a greater tolerance and latitude and proceeded to make use of it. As a result, the branch organization became so completely identified with the evils whose spread it facilitated that it was treated as a culpable accessory. As clearly as we see in the branch organization today a source of strength, just so did our forefathers see in it a source of weakness. The abuses which cast their blight upon the branch system have been extirpated and it may well be that under modern conditions of banking a branch organization can give an entirely different and much more commendable account of itself. It should also be remembered that some of the virtues which we see

[27] Cleveland, Powell, *Railroad Promotion and Capitalization*, pp 167-173.

in the ramifications of a bank could not be appreciated by the citizens of this earlier era We have admitted diversification as a sound principle of investment for the individual as well as for the bank, diversification not only as to the situs of investment but the industry itself. That is to say, we believe in geographical as well as functional diversification. Our more primitive bank clients failed utterly to see the value of such an arrangement. They felt that a local bank had no right to take the credit and savings of the community elsewhere. On the other hand, any applications for discount from without were viewed with suspicion. This was an alien appeal and indicated that the domestic market of the proposed borrower, than which there was none more competent to pass upon his capacity and integrity, was unwilling to accommodate him.[28]

Some Excellent Branch Systems—Indiana

In spite of the incubi of abuses under which the branch systems struggled, there were some conspicuous and honorable exceptions to the rule that branch organization was the symptom of discreditable banking. The State Bank of Indiana and the State Bank of Ohio deserve mention in this connection. The bank of Indiana was organized in 1834 as a parent bank with ten branches which

[28] Dewey, *op cit* p. 191 *et passim*

were later increased to thirteen. Each branch had a capital of $160,000. The parent bank had no capital at all and was merely a supervisory body consisting of a president and board of directors. The president and four directors were appointed by the state. Each branch selected one director. Aside from its supervisory functions, the parent bank engaged in no banking. We may look upon it as a holding company operating a series of federated banks. However, there is one very vital difference between the position and responsibilities of the subordinate members of the Indiana bank and a modern group held together by a holding company. The branches of the Indiana bank were independent as to assets but jointly liable for failures. The holding company device today has just reversed this arrangement. The assets of the constituent banks are held jointly. The earnings are distributed to a common body of stockholders. The separate corporate existence of each unit in the chain permits the losses of failure to be confined to a single unit. That is the legal situation. In practice, it may well be that the solvent members of the chain will come to the assistance of the bank or banks which are in difficulties. That remains to be seen. It is a mistake to attribute any talismanic qualities to the formula of association of the Indiana Bank. Its success was due largely to the character of the men conducting it, the reality of

its capital, the conservatism of its rules and the vigor and exacting nature of its inspections. If the branch organization imposed any limitations upon sound banking, these men rose above them.[29]

State Bank of Ohio

The State Bank of Ohio was established in 1845 with seven branches. It had a central board of control similar to that of the Bank of Indiana. When its existence as a state bank ceased in 1866, it had 36 branches. Here again we find a system of federated independent banks jointly liable for circulating notes, but independent as to assets and other debts. Since the note issues were the chief source of abuse, and since these banks were held liable for each other's excesses, each bank maintained a jealous watch of its associates. Combined with rigorous examinations and competent central supervision, the system was highly successful.[30]

Wisconsin Marine and Fire Insurance Company

The Wisconsin Marine and Fire Insurance Company is another example of successful branch banking. The unusual title of this bank was made necessary by the prohibition of all banking by the state of Wisconsin. Banking, however, meant merely the issue of notes. This failed to cramp the ambitions of George Smith, the canny Scotch

[29] See White, Horace, *op cit* 357-360
[30] *Ibid* pp 367-368

immigrant who founded the Wisconsin Marine and Fire Insurance Company. Organized ostensibly for the purpose of selling insurance, it soon commenced the discounting of commercial paper, and the issue of circulating certificates of deposit. Its main office was at Milwaukee with branches at Chicago, Detroit, Buffalo, Galena and St. Louis. In spite of doubtful charter rights, a hostile legislature and repeated runs for specie, it operated with uninterrupted success. Its good fortune must be attributed largely to the acumen and integrity of George Smith.

Conclusion on Pre-Civil War Branch Experience

On the basis of the pre-Civil War experience with branch banking in this country, we may conclude that the evidence leaves the verdict open as to the desirability and soundness of this form of banking structure. The testimony is more decisive in another direction. There is little in the case against branch banking as revealed in this period of our history to indicate that it is repugnant to the intrinsic temperament of the American race. If we contemplate a legislative or economic process for the purpose of discouraging the growth of the branch organization, it should be based upon other and more substantial grounds than incompatibility with American genius.

CHAPTER IV

THE CASE FOR GREATER BANKS AND BRANCH SYSTEMS

BEFORE ATTEMPTING to play the cold light of facts in so far as they are available and analysis in so far as it is effective upon the issues raised by the contending forces, it may be well to reveal these issues through the polemics of the two sides. It is not practicable to permit each eager spokesman to give his own peculiar interpretation of the truth as he sees it. That task has already been performed elsewhere.[1] From this general rule two exceptions will be made.

Two Advocates

No advocate of bank concentration, particularly through branch organization, has been so insistent and articulate as the present Comptroller of the Currency, J. W. Pole. Fortified by the disinterestedness of high public office and the intimate and expert knowledge of the problem which his official duties bring he speaks with great author-

[1] See *American Bankers Association Journal*, Oct., 1929, Jan., 1930; Feb., 1930 Whaley-Eaton Pamphlets, *Questionnaire on Branch Banking*, Nov 22, 1929

ity. Even though he were dead wrong, which may not be the case at all, his views command attention. On the other side of the case, speaking with pungent vehemence and the earnestness of profound conviction, we shall yield space to another authority of equal weight, Henry M. Dawes, addressing us in his official capacity as Comptroller of the Currency. Mr. Pole speaks in the year 1929, Mr. Dawes in 1923. The brief space of six years separates them. Is it possible that American banking conditions have undergone a change so revolutionary that the opinions of such high authorities could reasonably pass through an arc of 180 degrees? Certainly the passage of six years could not have shattered those epic virtues in unit banking which Mr. Dawes so clearly discerned in 1923. Certainly the blighting afflictions which are now fatally undermining the health of our unit banking structure, according to Mr. Pole, must have been in some evidence a brief six years ago. The only reasonable conclusion which a faltering layman may embrace is that these two able judges have cast their perspicacious scrutiny upon substantially identical conditions and have expressed utterly contradictory judgments.

Mr. Pole and the Small Unit Bank

Here is Mr. Pole leading off for the prosecution.

"While the largest and strongest banks with the bulk of the banking resources are in the large cities, about three-fourths of all the banks in number are in the smaller towns and cities and may be classed as country banks. It is these banks which serve directly the agricultural communities. They operate with small capital funds and are very much limited in their ability to employ a trained management. The economic developments of the post-war period have had the effect of decreasing the opportunities of these banks to operate with profit and it is this situation to which I should like to direct your most serious consideration.

Bank Failures

"We are faced with the fact that during the 9-year period from July 1, 1920, to June 30, 1929, inclusive, about 5,000 banks, nearly all in the agricultural communities, closed their doors and tied up deposits of approximately $1,500,000,000.[2] These failures have not been limited to any one section of the country, although they have been most prevalent in the agricultural districts. Up to November 1, 521 banks with deposits of about $200,000,000 had suspended during the year 1929 The number of failures by states during the fiscal years ending

[2] These figures embrace only those banks which actually went into the hands of receivers They do not include about 500 banks which suspended business but were later reopened after reorganization, often resulting in depositors and shareholders voluntarily suffering some loss.

FAILURES BY STATES DURING FISCAL YEARS ENDING JUNE 30, 1921 TO 1929 INCLUSIVE

	State and private	National
Maine	3	
New Hampshire	1	
Vermont	1	
Massachusetts	15	1
Rhode Island	1	1
Connecticut	2	1
Total New England States	23	3
New York	10	2
New Jersey		
Pennsylvania	26	11
Delaware		1
Maryland	5	1
District of Columbia		1
Total Eastern States	41	16
Virginia	29	2
West Virginia	21	4
North Carolina	98	12
South Carolina	170	21
Georgia	293	12
Florida	110	13
Alabama	22	4
Mississippi	40	3
Louisiana	33	1
Texas	178	39
Arkansas	80	8
Kentucky	40	
Tennessee	56	3
Total Southern States	1,170	122

FAILURES BY STATES DURING FISCAL YEARS ENDING JUNE 30, 1921 TO 1929 INCLUSIVE

	State and private	National
Ohio	28	8
Indiana	78	13
Illinois	68	13
Michigan	63	2
Wisconsin	57	8
Minnesota	320	58
Iowa	386	81
Missouri	241	5
Total Middle Western States	1,241	188
North Dakota	385	59
South Dakota	264	51
Nebraska	279	28
Kansas	182	12
Montana	136	55
Wyoming	52	11
Colorado	60	16
New Mexico	40	20
Oklahoma	174	53
Total Western States	1,572	305
Washington	41	8
Oregon	36	7
California	13	16
Idaho	48	25
Utah	13	4
Nevada	2	
Arizona	27	3
Total Pacific States	180	63
The Territory of Hawaii	1	
Total United States	4,228	697

June 30, 1921 to 1929, inclusive, is shown in the accompanying table.

Heavy Percentage of Failures

"As will be observed from the accompanying table the failures of state chartered banks greatly out-number those of the national banks, but small national banks have not been immune to the conditions which are causing the failures of small country banks generally. As an illustration of the wide scope of this economic condition, it may be said that in seven states over 40 per cent. of all the banks in existence in 1920 have failed and in six states between 25 and 40 per cent. In 26 states, or more than one-half the total, over 10 per cent. of the banks that were in operation in 1920 have since failed. When it is considered that no important failures have occurred among banks in the larger cities, the ratio of failures in the country districts is even higher.

City and Country Depositors

"We have here, therefore, a strong contrast between city and country bank operations. Whereas the depositor in a large city bank, whether a wage earner or a business man, has had full protection, the depositor in the small country bank has suffered severely from the inability of so many of these banks to meet their deposit liabilities. The

farming communities have not been afforded the protection for their savings which has been available to depositors in the large cities.

No Prospect for Improvement

"It is cause for immediate concern that the operating conditions faced by the country banks show no prospect of improvement under the present system. There are many country banks now operated at a loss and many others operating upon earnings insufficient to justify their capital investment. There is not available to me the earning statements of state banks, but taking the national banks as an illustration and the year 1927 as a typical year (later earning figures not being compiled), 966 national banks operated at a loss and an additional 2,000 earned less than 5 per cent. These constituted about 38 per cent. of all national banks in the United States.

Collapse of Rural Banking

"Comprehensive study of the banking situation for the past nine years clearly indicates that the system of banking in the rural communities has broken down through causes beyond the control of the individual banker or the local community. These causes are of a basic nature and have many ramifications throughout the great economic and social changes which have occurred in the United

States since 1914. I shall not attempt in this report a detailed analysis of this situation except to say that the economic movement away from a large number of independent local utility and industrial operating units toward a stronger and more centralized form of operation in the large cities has curtailed the opportunities of the country bank for diversity and extension of business while broadening these opportunities for the large city bank.

Legislative Support Not a Solution

"Any attempt to maintain the present country bank system by force of legislation in the nature of guaranty of deposits or the like would be economically unsound and would not accomplish the purpose intended. If in the free course of business the country bank can not successfully operate as an independent banking corporation, affording ample protection to its depositors and its stockholders, the obligation and responsibility is upon the Government of the United States, at least so far as the national banks are concerned, to set up a system of national banking which will insure the rural communities against the continuing disastrous effects of local bank failures. . . .

Private Initiative Attempting a Solution

"In the absence of legislation to remedy the conditions above described, private enterprise has

within recent months undertaken to meet the economic situation presented by the growing isolation of the country banks. Local holding companies have been formed in many sections of the country for the purpose of bringing together a number of banks into a single operating group. The usual procedure is for the holding company, a state corporation, to purchase a majority of the stock of several banks, one of which would be a large city bank which in effect becomes the parent bank of the group. The management personnel of the central bank becomes in practice the responsible management for the entire group. Through such a group system it appears to be possible to make a close approach to a form of branch banking whereby each operating unit leans for support upon the central bank, or upon the holding company, and receives the benefits of its moral and financial support; its prestige and good will; its extension of the wider type of banking service; and the benefits of its highly trained management. . . .

Duty of the State

"It appears that in many cases some of the most responsible bankers and business men of the community have been instrumental in the organization of these holding companies and this it would seem is a sufficient indication of the seriousness of the purpose behind the movement. However, these

holding companies are attempting to do under the sanction of existing laws, which are crudely adapted to the purpose, what should be made possible in a simpler manner by new legislation. If branch banking were permitted to be extended from the adequately capitalized large city banks to the outlying communities within the economic zone of operations of such banks, there would be no logical reason for the existence of the local holding company and it would give way to a system of branches operated directly by the central bank of the group.

Greater Latitude for Branch Organization

"These conditions would seem to warrant a further amendment of section 5155 of the Revised Statutes of the United States as amended by the Act of February 25, 1927 (U. S. Code, title 12, sec. 36), known as the McFadden Act, to permit national banks, with the approval of the Comptroller of the Currency, to establish branches within the trade areas of the cities in which such banks may be situated. These trade areas may in some cases be coextensive with federal reserve district lines; in other cases they may be of a more limited extent, but in my judgment they should not extend beyond federal reserve district boundaries, except to take care of a few exceptional cases where a trade area may extend from one federal reserve district into another, nor should a bank be permitted to estab-

lish a branch in another city in which there is a federal reserve bank or a branch thereof.

Safety and Independence

"Under such a system of branches there would gradually be extended to the agricultural communities from the large city banks a safe and sound system of banking which would render remote the possibility of bank failures. There would, however, be no compulsion upon unit banks to enter a branch organization. The two systems of banking—unit banking and branch banking—would no doubt operate side by side for an indefinite length of time; that is to say, there would be in every rural section some unit banks well organized, competently managed and held in high esteem by the community, which would continue to operate advantageously.

Protection to National System

"These suggestions for branch banking are made not with the intention primarily to deal with the question of the decline in the number of national banks through defection from the national to the state systems, but rather as a remedy for what appears to be a serious and fundamental weakness in our systems of banking both national and state. Such a grant of power to the national banks would, however, give them such an outstanding operating advantage that it would seem reasonable to expect

that the exodus of banks from the national system would practically cease and that many now under state supervision would return to the national charter which they have forsaken."

"The Purposes of Their Creation"

In his testimony before the House Banking and Currency Committee (February 25, 1930) Mr. Pole further stated that—". . . . our small independent unit banks are no longer fulfilling the purposes of their creation and there is need for a better, sounder and stronger system."

Safety of Metropolitan Banks

"There are great commercial centres in the various regions of the United States. In these commercial centres have been developed great metropolitan banks, among which there have been no failures during the period we have under discussion and no depositor in these banks has suffered a loss.

The Worker

"The laboring man and the small wage-earner in these cities are receiving a stronger protection and a higher and better type of banking service than is possible for the farmers and small business men who must do business with country banks." [8]

[8] *New York Times*, Feb 26, 1930

Decentralization

He proposes an extension of the branch system. By permitting branch expansion in areas outside of New York there will be created strong banking units which will offset the excessive concentration of banking resources in New York City and will tend to modify rather than aggravate the danger of undue centralization. It will set up other strong centres in competition with New York.

Moreover he sees in the reduced number of banking units an advantage which appeared to his predecessor, Mr. Dawes, as a grave defect. Mr. Pole argues that a smaller number of banks can be supervised more effectively than a larger number.

A Skillfully Prepared Case

In due time we shall have Mr. Dawes make his reply to this point. In the meantime, let us admire the present Comptroller's skillful adaptation of the evidence to the political exigencies of the case. He is testifying before a congressional committee which is meticulously apprehensive of monopolistic concentration. In the hands of Mr. Pole the branch banking movement while presenting the superficial aspect of centralization is actually precisely the opposite. It is merely a concentration of the elements antagonistic to centralization. Nor does the Comptroller fail to inject a solicitous

reference to the wage-earner and laborer in the big city whose savings have been protected by the great banks. They have been the beneficiaries of a "higher and better type of banking service."

Winning the Farmer

In a country where the agrarian party is as vociferous and powerful as in the United States changes of this type must be definitely related to agricultural progress in order to win political acceptance. It is not surprising, therefore, to discover in one camp that the independent unit banker has been the refuge of the farmer in time of need, his forward propelling and sympathetic ally at all times, while in the other camp the limitations of unit banking are elaborated and the consequent distress to both the farmer and the banker indicated.

Branch banking, it is affirmed, proves a great aid to agriculture no less than to sound banking. The bulk of the farmer's income and expenditure is seasonal. He does most of his spending in the spring and most of his receiving in the fall. This is very disturbing to the business of the banker. He functions best when he can count, within narrow limits, on compensating streams of deposits and payments. It is well known that the banks of the country could not pay more than a minute fraction of their total liabilities if demand were made at the same time. Any material concert on the part of

the depositors either through fear or malice would catapult the average bank into the void of insolvency. Its safety depends upon the law of averages. On no ordinary occasion are the demands for payment greater than the receipts by an amount which cannot be met by the bank's reserve. An equable flow in both directions is the foundation of stable banking. The peculiar nature of the farmer's business makes it impossible for him to play the game according to the rules of tranquil banking. Take the case of a certain bank in a small town in the cotton district of a southern state. In the winter its deposits are $240,000 and loans $8,000. In the summer, deposits drop to $90,000 and loans rise to $190,000.[4] Furthermore, there is a marked increase in currency requirements and fearful adverse clearing-house balances as the funds loaned are spent largely outside the community. For the small bank with limited capital and inadequate correspondent support, this is a truly harrowing annual recurrence.

Making Life Easier for the Country Banker

A branch system can take the summer tension out of this small banker's life. Funds can be shifted from areas of redundance to areas of scarcity. Furthermore, the assets of a chain or branch group permit a diversification which is not open to the

[4] *American Bankers Association Journal,* Oct. 1929, p 18

small banker serving a community devoted to a single interest. The eggs are no longer in a single basket, a figure of speech which the farmer grasps with professional appreciation. We find, therefore, that branch banking removes a premature cause of old age from the existence of the country banker, the depositor is safeguarded, the farmer is accommodated more effectively and everybody is happy.

Keeping the Borrower at Home

So much for the farmer. There are thousands of banks in country districts whose owners have no more capital invested in the business than the local garage owner. Since the amount which a bank can lend to a single borrower cannot exceed a definite percentage of the capital and surplus the power of accommodation of an institution with a capital of $25,000 is distinctly limited. The local cattle dealer or storekeeper will often require more than ten per cent. of that amount. There is no alternative for him but to go elsewhere and the small banker loses attractive and safe business. Page the branch bank. It is the specific for this defect. The business man saves time and gasoline. His conscience is spared the uneasy knowledge that he has been compelled to place elsewhere business which his friend the local banker cannot accept. This wandering entrepreneur has also been preaching the doctrine of

home patronage to his clients. Branch banking, therefore, will add definitely to that sum of human contentment which is the advertised object of all enterprise.

A Wider Vision

The last point suggests another reputed advantage of the branch system. The local captain of industry often produces for a market that reaches far beyond the bounds of the little bailiwick which the local bank serves. If he has any disposition to local-mindedness he must discard it in the face of broader interests and a dependence upon conditions which prevail in other than the home provinces. This interdependence affects the local manufacturer both in the distribution of his products and the purchase of his materials. Such catholicity of interest does not hold for the small country banker. His sun rises and sets in the home area and he is less than likely to view the "alien" commitments of the entrepreneur with sympathy. He is unable to grasp the problems of this enterprising producer. This inability plus a straitened selfishness makes him disinclined to give that full measure of assistance which the entrepreneur could expect from the branch of a great bank. The interests of the latter traverse local lines. The executives which pass upon his application are men of greater capacity and broader

vision than the local banker. They are in a position not only to grant the loan but to advise their client in his own decisions.

Expert Service

When the local merchant wishes to make a will, or establish a trust fund or invest his surplus capital in securities he can go to the branch of the great bank with a confidence which cannot animate him when he talks to the local independent banker. Each service is handled by a trained expert of the highest calibre. The connections and size of the large bank assure a degree of safety beyond the capacity of the small bank. Nor may we stop here with the gain to the client. The security of the bank itself is involved. The great bank can afford a statistical service and a type of investment intelligence which will go far to avoid the hazards of unwise commitments. The small independent banker, unless he is willing to commit his investment program to a reputable bond-house, moves in the dark and is likely to make many costly errors of judgment. The writer recently examined the reported bond portfolios of a number of representative banks which had placed themselves under the direction of an investment house. He was amazed to discover in a large number of cases bonds of which no record could be found. The banker,

depending upon his own free judgment, proves as susceptible to gold brick propaganda as the traditional farmer.

Importance of Careful Investment Management

The growing importance of careful investment management in the security of the banking structure is revealed by the relative growth of investments in the portfolios of our banks during the period 1920-1929.

PORTION OF TOTAL RESOURCES OF NATIONAL BANKS DEVOTED TO BONDS, 1920-1929

Year	Total resources (In Millions)	Total Bonds and Securities (In Millions)	Ratio of Bonds and Securities to Total Resources, Per Cent
1909	$9,574	$1,662	17.4
1920	23,411	4,187	18 0
1921	20,517	4,025	19 6
1922	20,705	4,563	22 0
1923	21,511	5,070	23 6
1924	22,565	5,142	22 8
1925	24,350	5,730	23 5
1926	25,315	5,842	23 1
1927	26,581	6,393	24 0
1928	28,508	7,147	25.1
1929	27,440	6,657	24 3

During the course of the amalgamation movement in England it was invariably found necessary to revise radically the investments of absorbed

banks.[5] There appears to be ample room for improvement along this line in our unit banks and it is assumed that an extension of branch banking will effect precisely that.

Lack of Uniformity in Unit Banking

For years our currency and banking system suffered from a lack of uniformity which proved inequitable to individuals, groups and whole regions. The cry, therefore, has been for greater uniformity to relieve the victims of that unwitting discrimination which diverse banking imposed. This diversity applies to all the conditions which attend the business of banking. Interest rates vary from region to region and often the group least able to pay the highest rates must in fact do so. That applies merely to the apparent rates. If we calculate the rate by comparing actual and total cost to the amount of credit used we find the disparity between different sections of the country still further emphasized. Practices involving collection and float, payment for service charges, minimum deposits, relation of deposits to line of credit, bonuses, renewals, one and all they vary with the community and the character of the individual banker. Sweep this heterogeneous incubus of unit banking aside,

[5] Sykes, Joseph, *The Amalgamation Movement in English Banking*, p 125.

aver the champions of branch banking, and substitute reasonable and standardized practices.

The Tyranny of the Unit Banker

Furthermore, it is preposterous in this age of light that the fate of credit applicants throughout the length and breadth of the land should depend upon the capricious judgment of a single mind. Independent banking is autocratic banking. Lending policies emerge from the erratic idiosyncracies of the individual banker. In rare cases this banker may rise above his level and be free of those prepossessions which corrode any act of free judgment. By and large the success of an application depends upon the psychic aberrations of a common man, the frail object of limited or biased impressions. Group and branch banking puts an end to arbitrary banking. Where the manager of a bank in a group or a chain is personally responsible to distant superiors and detached stockholders and is guided by a wholly impersonal body of rules he must curb any tendency toward favoritism or discrimination. What a contrast he is to the president of the small local bank who holds most of the stock in his own pocket!

In justice we insist upon the rule of law rather than that of men. Why not apply the same sound principle to banking? Is it not better to base credit accommodation upon a careful analysis of the bor-

rower's statement than upon the enthusiasm of the president or other officers for some local boom?

Ubiquity of Branch Service

Finally, say the advocates of branch and group banking, it is possible to place a small branch of a great bank in a community which cannot afford an independent bank. Thus the humble citizen of Four Corners can have the same banking service and safety as his more favorably located cousin in the metropolis.

Summary of the Case for Branch Banking

We may summarize the arguments in favor of concentration and extended branch systems as follows:

The unit system of banking in agricultural sections is neither safe for the depositors, profitable for the stockholders or adequate for the borrowers. The great banks assure sound diversification of loans and investments, greater mobility of funds, greater uniformity of charges and superior security and trust service for the client. With their branches they emancipate the local borrower from the tyranny of the unit banker.

CHAPTER V

ON BEHALF OF THE UNIT BANK

THE TWO trump cards played by the present Comptroller of the Currency in his plea for greater latitude for the development of branch banks are the lack of safety of the small unit banks in agricultural districts and the failure of these same banks to make reasonable profits. The latter indicates a further susceptibility to the forces which have been causing bank failures and augurs a future as sombre as the past. That this is not an idle apprehension he demonstrates in his testimony before the Banking and Currency Committee of the House on February 27, 1930. During the year 1930, in less than two months, 22 national and 109 state banks had already failed and the dark list of expired institutions for the period June 30, 1920, to February, 1930, had mounted to 750 national banks and 4,900 state banks. If the rate of failures indicated during the early part of 1930 continued, that year would be blackened with more than a thousand failures.[1]

Failures a Reflection of Regional Distress

The defender of the unit bank replies to this charge. He must. It is serious. He sees in the

[1] *United States Daily*, February 28, 1930

excessive and disastrous toll a reflection of regional and occupational distress rather than a fundamental defect in the unit banking system. These failures have been concentrated in the Middle West and the South, both regions suffering from economic maladies which have thus far failed to yield to treatment. We may take the Comptroller's list of states in which more than thirty per cent. of the banks have suspended during the period 1921-1929.[2]

AREA OF GREATEST BANK FAILURES

State	Total number of banks June 30, 1920	Suspensions 1921-1929	Percentage of suspensions to total number of banks
Arizona	87	21	31 0
Idaho	222	72	32.4
Wyoming	160	60	37 5
Georgia	738	319	43.2
Montana	431	203	47.1
North Dakota	898	429	47 8
South Carolina	461	227	49 2
New Mexico	123	662	50 4
South Dakota	694	394	56 8
Florida	265	190	71.7

Agricultural Resistance to Deflation

It is well known that agriculture resists the process of deflation with a tenacity that is peculiar. That is due partly to the utter impossibility of submitting it to a thorough purging process such as that sustained by other forms of enterprise and also to the fact that the farmer can hang on long after he has become insolvent according to every test of

[2] *Ibid.*

accounting income. In other fields of production and merchandising the failure to win an income sufficient to pay expenses promptly brings the receiver and the sheriff's hammer. The tragic debris of failure is swept aside. The principals are released from their burdens and contracts and from the *tabula rasa* of utter entrepreneurial extinction they can start anew under other auspices. The character of the farmer's assets does not permit such summary cauterization of infected regions. He clings to his occupation and "plant" with the desperation of despair. In this course he is abetted by the passive approval of his creditors who dare not demand the last pound of flesh for fear that it will spell their own doom. Of all the creditors none are in such a thoroughly painful devil-and-deep-sea-position as the banks. They dread the day when they must admit the chill verdict of insolvency. For many banks that day has come at some time or other during the dismal decade. It is the reckoning which agriculture is finally paying for its inflation during and after the war. Agriculture is the culprit, say the pleaders. The small unit bank is the helpless victim of occupational distress.

Too Many Banks

A second cause of susceptibility to failure has been the indiscreet indulgence of our state banking codes. In their desire to encourage the establish-

ment of state banks and the extension of banking facilities to small rural communities they have reduced the capital requirements to a point incompatible with safety. The states have exercised no restraint in the granting of charters. There has been no disposition to question the judgment of those who sought charters nor has there been any effort to determine the need of a community for the bank seeking to serve it. A little birth control of banks on the part of the states which now suffer most from bank failures might have had a wholesome effect on the rate of mortality.[3]

Small Banks and Profits

A large number of the unit bankers rise in vehement protest against the charge of the Comptroller that they cannot make fair profits. They assert that profits are a reflection of able management and community prosperity. The possession or lack of branches as well as size have nothing to do with the rate of profits The statistical evidence on this point we shall consider in a later chapter.

Great Banks Not Immune to Failure

Suffice it to say here that the defender of the unit bank on the score of safety and profit can point to the history of banking spotted with the bleached bones of great banks which have fallen

[3] See Report of Economic Policy Commission, *American Bankers Association Journal*, 1927

by the wayside. He can recall the collapse of Baring Brothers in 1890 which precipitated bank and industrial failures throughout the world. Included in the stricken areas was Australia which had a widely ramified branch banking system [4] The great branch systems of post-war Italy [5] and more recently of Japan [6] were not immune to the forces of industrial depression. Moreover, when these vast systems fell they affected so many related interests that the consequences were felt throughout the land. In our own country we may concede the gravity of widespread bank failures. Due to the fact that they are unit banks with limited interests the correlative isolation of effects is a definite advantage.

Lack of Safety in Multiple Banking Units

In a chain or branch group the greater latitude of the management, the greater ease with which operations can be concealed and the relative impotence of government inspection are a constant temptation to unscrupulous or reckless direction. Furthermore, the present trend of concentration enhances the safety of such compromises with trust. The chain organization permits the isolation of failures. The weakness of one district or bank need not affect the other banks in the chain. There is

[4] Conant, Charles A , *History of Modern Banks of Issue,* p 544

[5] Commission of Gold and Silver Inquiry, U S Senate, *Foreign Currency and Exchange Investigation,* Vol I, pp 165-166

[6] Department of Commerce Bulletin, No 653, *The Big Five in Japanese Banking*

no community of responsibility save only such as the moral sensibilities of the owners impose. Each unit is a distinct corporate entity and if failure comes the receiver can look no further than the assets of the submerged institution. On the other hand, if the bank is profitable its earnings are divided among the absentee owners. The latter, incidentally, have availed themselves of a further modification of the traditional liabilities of the stockholder. Through the holding company device they have effectively divested themselves of double liability without at the same time surrendering any of their own rights.

Bank Changes and Speculation

There is a strong feeling among the independent bankers that the present hue and cry for greater statutory freedom in effecting concentration comes not from any desire to serve embarrassed communities, to rescue independent banks floundering on the edge of bankruptcy or to provide greater safety to depositors but merely for the purpose of riding the crest of a speculative wave and fully exploiting for selfish advantage the confidence of the public in the reputed merits of consolidation. Certainly, say these men, only the profits of promotion can justify the inflated prices which are being paid for the stocks of independent banks whose inclusion in chains is sought. The cry for branch banking comes

not from business in the form of complaints that the existing bank organization is unable to meet adequately the needs of the commercial community. It comes, on the contrary, from the forces seeking concentration on the strange ground of self-preservation.

The Unit Banker and His Community

The strongest contention of the unit bankers is the identity of interest of the local bank and the community which it serves. If the principle of local government is sound in politics then it is sound also in finance. Undue concentration in the one leads to a time serving and incompetent bureaucracy, dominated by formal rules and utterly without that capacity for particular adjustment which is the secret of good government. Undue concentration in the field of finance is destined to give us a banking system guided by distant and uninformed management, administered locally by servants without vision whose subordination to rigid rules will kill the spirit of enterprise. Although the power and facilities of the small local bank are limited, they are often more than compensated by the measure of personal attention which the small banker can give. Such intimacy between the official of final responsibility in the local bank and the applicant permits appraisal on a character basis. Many meritorious borrowers to whom loans can safely be made

are unable to present the precise statements necessary to secure credit under a vast branch system. The branch manager must park his judgment of the suppliant outside his office and refer to rule number 138, sub paragraph (d) in the manual for branch managers as modified by the circular letter of the supervisor of branches of the 15th of February.

Glorifying the Balance Sheet

The progress of a country depends upon the willingness of capital to take risks which may be of a speculative character. American capital, under competitive pressure, has always been willing to take these risks. The reputable entrepreneur, with a sound but speculative project, may appeal to twenty or thirty different institutions in a number of different cities. Under the circumstances his chances are fair of finding at least one bank executive with the perception to appreciate the merit of his project. In England he has but five banks to which he can appeal. In America this applicant can deal with the bank executive of final responsibility. In England his appeal must be committed to paper in statement form and submitted to the absentee judgment of the home office committee. Result—the exaltation of the balance sheet and the subordination or total elimination of qualitative personal factors.

Importance in Agricultural Communities

This qualitative factor is of particular importance in agricultural communities. The farmer is rarely in a position to keep accounts. His collateral is not the type which the average banker cares to handle. Unless he can lend Farmer Jones $500 merely on his knowledge of Jones and his confidence in the ability of the man to repay the loan, Jones will have to go without the loan or seek his credit indirectly through traders who can satisfy the requirements of the bank. We shall see later how the English and Canadian farmer reacts to the branch system.

Some Views

This point is aptly expressed by a business man who has replied to the Whaley-Eaton questionnaire.

"I doubt that the urbane young men who, under a branch banking system, will be shipped to outlying country branches for brief managership tenures, only to be recalled later to other branches or the home office, can ever successfully replace the present permanent country banker, even though their general training in economics and finance may be vastly better. And the economic development of the territories served will suffer as a consequence."

From London a merchant echoes this sentiment:

"The risk involved in having independent local banks is so small that it is negatived to atomic size by the advantages. Branch-banking, gradually, in a period of from ten to twenty years, produces a new class of bankers—elderly clerks of the mass production type. At least seven of these are now general managers of London Joint Stock Banks."

From our own West we get the view of a business man who has had experience with branch banking in California:

"As it works out in California branch banks are run by clerks who make loans according to rules set out by the central office."

The Unit Banker in the Community

So far we have considered only the relation of the banker to his client. It is necessary to consider his position in the community in its broader aspects. The unit banker is usually one of the leading citizens in the town. Even though he occupies no public office his views are sought on all questions of civic importance. When funds for a new hospital are being raised like as not the local banker is found in the forefront of those who are leading the campaign. When the state legislature is deter-

mining the location of a new highway, we find the banker representing his community and pleading its interests. The local church, the seasonal philanthropies, the local school, all make grateful acknowledgment to the local unit banker who cheerfully contributes of his time, energy and wealth to promote their welfare. How can the subordinate official, the temporarily placed branch manager of a mighty financial house ever take his place? He may in mechanical fashion succeed as a respectable and influential citizen. He is guided by sterile rules, under the impersonal direction of distant superiors. He will move with the local tide but he will never lead it. He cannot travel the second mile.

Monopoly

Although our bankers and business men make little mention of it, we must consider another count against banking concentration which the hosts of politics will not neglect. Monopoly. Money trust. What toothsome political phrases. When one contemplates the invincible prepossessions of the provinces against capital power, and how destitute our great political parties are of real issues, it is idle to suppose that this spectre will not be summoned in a thousand different shapes. It has all the qualifications of a first-class political issue. Here, again,

we shall defer a more careful examination of this phase of our problem to a later chapter.

Another Comptroller of the Currency

Let us turn now to the former Comptroller of the Currency, Mr. Henry M. Dawes:

Unit Banking a Natural Response to American Conditions

"The development of the American banking system has been an evolutionary process, and the preeminent strength which it possesses in world finance at the present time is in large measure due to the fact that it took its form in a gradual and orderly way, meeting, by practical adjustment, conditions as they developed. It is distinctly not an adaptation of any foreign system, nor is it a structure conceived and built by any individual or group of individuals at a given time involving the rigid enforcement of a ready-made theoretical plan. Under our system of banking the most stable and most rapid economic development that the world has ever seen has taken place.

Previous Attempts to Impose Foreign Banking Systems a Failure

"From time to time efforts have been made to substitute for the old machinery a system which might seem to be theoretically and technically more perfect. The frontal attacks of the proponents of

foreign banking systems have invariably broken down without, in any substantial manner, permanently modifying or affecting the general principles of American banking. The genius of the American people for independence in matters of local self-government is thoroughly ingrained and will never succumb in any clean-cut issue where the choice rests between centralized control and personal and community independence. . . .

Is a New System Desirable?

"If a new system and theory of banking is in progress, it should be determined whether or not it is a desirable system; and if a desirable system, it should be encouraged, fostered, and put into effect as rapidly as possible. If it is not a desirable system, that fact should be developed and steps should be taken now to eradicate it before a condition has developed which would involve a great national disturbance and injustice to individuals and communities.

Definition of a Branch System

"The above observations apply to the general subject of branch banking. By branch banking is meant an association of banking houses operating in one or more cities or towns but all under the discretionary control of the board of directors of a parent bank and upon the capital of the parent bank. . . .

Some Questions

"The discussion of branch banking seems naturally to divide itself into three main questions:

"First. Is a reserve system, either governmentally or privately controlled, necessary?

"Second. Can the present Federal Reserve System survive the imposition upon it of large and powerful chains of branch banks which, in practice as well as in theory, are privately owned and privately controlled reserve systems?

"Third. Can a general system of branch banks exist simultaneously with a system of independent unit banks?

Branch Banks Versus the Federal Reserve System

"If it should be concluded, in the consideration of these questions, that the Federal Reserve System is necessary and that it can not survive the strain upon it of systems of branch banks, and that branch banks will mean the elimination of independent banks, it will then, I believe, be a logical and necessary conclusion that *the issue is a clean-cut one as to whether the country prefers a system of privately owned branch banks or a reserve system under federal control.*"

To repeat the Comptroller's able defence of the Federal Reserve System would be an undue digression from this argument. We will content ourselves with a summary of his position on the

questions which he raises. He sees in the development of great banks with far-flung systems of branches a threat to the efficacy and usefulness of the Federal Reserve System. In view of Mr. Pole's assertion that concentration would facilitate the supervisory task of the state, we will quote the views of Mr. Dawes:

Branch Systems and Bank Inspection

"The examination of an institution with branches and subsidiaries is a very difficult one. The inter-departmental relationships vastly complicate it. It is more difficult to examine 10 institutions of a given size which are associated in a branch banking system than it would be to examine 10 independent institutions, as all of the transactions between the different branches have to be investigated and eliminations and adjustments made to produce a composite picture and prevent the improper manipulation or shifting of assets. This can not be done satisfactorily without a simultaneous examination of the parent bank and all of the branches. Bank examination involves very much more than a mere scrutiny of figures. Questions of moral character, of local reputation, of valuations of securities, of conformity to laws and rulings—these and many other elements enter into a proper examination. In the case of the examination of a large bank, with 75 or 100 branches, it

would be impossible to mobilize a force of examiners of the ability to make an intelligent analysis of the situation in each individual community, even if it is to be assumed that the character of the banker is not a factor in the condition of the institution."

Branch Banking and Unit Banking Cannot Survive Together

Mr. Dawes is unable to see how a unit banking system can survive a branch banking system. He draws upon the experience of other nations and comes to the conclusion that unlimited branch banking would sound the knell of all independent banking. In such an event he sees an irreparable loss to American life. It were paltry reward to an institution which has played a leading and causal role in the development of America.

Unit Banking and Character Loans

"In a system of independent unit banks, the bank which best serves the community is the bank which is most certain to live the longest and be the most profitable to its stockholders. Since the type of man who starts a bank in a small community is essentially constructive, his natural associations and sympathies are with men of constructive type, and he extends the facilities of the bank most liberally to them. His loans take into account, as a first consideration, character and moral responsibility.

He is naturally inclined to encourage young, aggressive, and enterprising individuals who will, in the course of time, bring business to the institution as he succeeds, and will develop commercial and industrial enterprises and be a factor in the creation of corporate and private undertakings, all of which will be feeders to the bank. As this type of individual is usually not the possessor of high-class collateral at the beginning of his career, the banker is dependent in a large measure upon character, of which he can only be sure by personal contact and acquaintance.

Unit Banking a Stimulus to Enterprise

"The distinctive accomplishment of the banking system of the United States is its contribution to enterprise and its stimulation of growth; its criterion is service.

"It can well be said that the rapid economic development of America has been largely due to the policy of the pioneering unit banks which recognized this principle of service. It is inconceivable that the representative of a non-resident board of directors should be granted the authority and the discretion to make a type of loan which is based on character, knowledge of local conditions, and ultimate benefits to be realized by the community and by the banks."

A Deplorable Transformation

Nor does he believe that this capacity for service can long survive the establishment of a branch banking system.

"One of the monopolistic influences exerted by the branch banker is the ability to secure, by the payment of higher salaries, the transfer to other points of the efficient employees of the unit banks. A general procedure in the creation of branch banking systems in one of our American states has been the absorption of local unit institutions. During the first few years the operations of these local unit institutions have, in many cases, been successful because the enterprising and pioneering talent that created the bank is still retained in an official capacity, but men of this type will not long consent to hold positions which are, in their essence, merely advisory, and there is soon substituted therefor the type of employee who must be bound by rigid instructions and is capable of interpreting them in only a mechanical way."

Summary

We may summarize the case for the unit bank as follows. The conclusion of the Comptroller that our present epidemic of bank failures is the result of the size of our banks and their independence is unwarranted. The banks which have failed have in a large measure been dragged down by regional

depression. There is no relation between bank size and profits. Granted identical conditions of community prosperity the small bank can do just as well as the large bank. In the capacity of the local banker to interpret the community which he serves, to suspend the inflexible rules of mechanical large scale banking and to encourage the spirit of enterprise the unit bank finds its strongest support. Banking is a profession—not a business. On the negative side of the argument, we may point to the danger of monopoly in great concentration and the jeopardy to the usefulness and power of the Federal Reserve System.

The Issues

In presenting the briefs for the two opposing sides we have been careful to exclude extremist views. We have confined ourselves to those contentions which were plausible and defensible in the light of our knowledge of economics.

The two parties have joined definitely on a number of issues which we will state in the form of questions.

1. Is large scale banking safer than unit banking?

2. Is large scale banking more profitable than small scale banking?

3. Which type of banking is best able to serve the community?

4. Will large scale banking emasculate the Federal Reserve System?

5. Will large scale banking destroy unit banking and lead to monopoly?

6. Will large scale banking help or harm the farmer?

In the following chapters we shall try to answer these questions.

CHAPTER VI

THE TEST OF SAFETY

THE MOST powerful single influence brought to bear upon Congress in its consideration of the banking problem is the legion of failures which has marked the period 1920-1930 as the dismal decade in American banking. When one state (Florida) shows a failure of almost three-quarters of its banks and ten states confess to a failure of more than thirty per cent., the seriousness of the situation cannot be denied.[1] The Comptroller of the Currency has come vigorously to the defence of the depositor whom he sees as the neglected and innocent victim of our banking casualties. His zeal is commendable.

It is possible, however, that the facts as he states them afford an exaggerated and erroneous impression. It is possible, also, that the implied cause of failure and the proposed remedy require modification for the sake of greater accuracy.

Failures and the Responsibility

In the 1929 report the public is startled by the statement that the bank failures of the past decade

[1] *United States Daily,* February 28, 1930

have involved $1,500,000,000. This is coupled with the observation that the preponderant majority of the defunct banks were small.[2]

This colossal burden, therefore, is laid at the door of the small bank and the summary remedy of extinction is recommended for the offending malefactor We are in danger here of embracing a grave misapprehension and doing an injustice to a form of bank organization which, be its faults what they may, has played an integral and stimulating role in American economic history.

Losses Exaggerated

In the first place, the impression of losses to the depositors which the figures of the Comptroller suggest runs away with the facts. American depositors have not lost a billion and a half dollars. Nor are they likely to lose a billion and a half dollars. The figure represents the deposits of the banks which have failed and takes no account of the payments which liquidation of the assets will provide. That such compensation to depositors is substantial is indicated by the record of previous receiverships. In the period 1865-1928 the Comptroller's office closed 782 receiverships. Of these banks 70 were restored to solvency and paid their creditors in full with no other loss than that of inconvenience. For the remainder the creditors

[2] *Annual Report of Comptroller of Currency,* 1929, p. 2

received 80.57 cents on the dollar.[3] If this ratio of losses is maintained for the state and national banks now in process of liquidation or reorganization, then the final net loss to our depositors on account of bank failures will not exceed ten per cent. of the crushing burden suggested above. While $150,000,000 is a substantial sum, it hardly entertains the same heroic remedies as a loss ten times as great. Furthermore, it is spread over a period of nine years. Its incidence is diffused throughout a vast territory and a goodly proportion of the depositors who lose are also borrowers who have gained.

Losses Not Due to Size of Banks

We have already adverted to the reply which the defenders of the unit bank have made to the Comptroller's indictment. The vast number of bank failures is granted and deplored That they are for the most part small banks serving rural communities is also true. That they failed *because* they were small banks or *because* they served rural communities has been vigorously denied. Their champions urged the promiscuous granting of charters and inadequate capitalization as the real evil rather than size or the Arcadian character of the community served. There is great force in these contentions.

[3] *Ibid*, 1928, p. 15.

Deposit Guarantee Laws a Factor

It is certain that the states which passed guarantee deposit laws (eight in number)[4] attracted a host of fly-by-night promoters who seemed to have no difficulty in securing charters from state commissions. They basked in the benign rays of state assurance of safety to depositors. The caution with which the depositor in a small town usually scrutinized the character of bank ownership and management was dulled by an illusion of impregnable strength. Deposits flowed forth and many incompetents or rascals (sometimes both) operating under the tenuous guise of bankers pastured in clover. These men have failed as bankers. Deposit guarantee funds have been exhausted and state insurance of bank deposit safety has become a discredited expedient.[5]

Indiscretion of Comptroller's Office

Nor has the Comptroller's office been entirely free of indiscreet indulgence of charter applicants. Dr. H. Parker Willis puts the case aptly:

"Bank failures have been numerous and they have been largely due to the unwise grant of charters to improper groups of people, often under pol-

[4] The following are the states which adopted guarantee laws with years of adoption: Oklahoma, 1907, Kansas, 1909; Nebraska, 1911; Texas, 1910, Mississippi, 1914, S. Dakota, 1915; N. Dakota, 1917; Washington, 1917. The last of these laws was repealed by Nebraska in February, 1930.

[5] See *Federal Reserve Bulletin*, September, 1925, pp. 636-668. *Barron's Financial Weekly*, January 6, 1930

itical influence. Mr. Pole himself, when he came into office, is authentically stated to have cut down the proportion of charters (as compared with applications) that was granted by about 50 per cent., but he could not put out of existence the banks that had already been unwisely chartered by his predecessors, one of whom is now under indictment in the District of Columbia. These predecessors granted charters that never should have been bestowed, and as a result we have a host of weak, unreliable banks that crowd one another out of existence by being too numerously organized in places where there is no support for the multifarious institutions that have been established there." [6]

Examine Number of Banks

That the progeny of our liberal state codes was excessive is revealed strikingly by the following facts. In 1920 the 11,000,000 people of the state of New York were served by 1056 banks, the 2,500,000 people of Iowa by 1,763 banks while the state of North Dakota with 650,000 inhabitants was attended by 898 banks. The citizens of the Empire State were well served apparently with one bank for every 10,400 of their number. The Iowans required one bank for every 1420 inhabitants. The Commonwealth of North Dakota could not fill its allotted place in the economic sun unless every 725

[6] *The Journal of Commerce,* February 28, 1930.

North Dakotans had a bank. In other words, the human base which supported one bank in New York supported 7.3 banks in Iowa and 14.3 banks in North Dakota. That may have something to do with the longevity of our banks. The above figures fail to do the situation full justice. New York is the richest state in the Union. Its industries are diversified. It contains the commercial and financial metropolis of the Western Hemisphere. One may safely conclude that any given number of inhabitants of the state are better able to support a bank than an equal number of the citizens of either Iowa or North Dakota. In view of all of which the bank failures of these three states for the period 1920-1929 are not surprising: North Dakota, 444; Iowa, 467; New York, 12.[7]

Another Authority Defines the Cause of Failures

The Economic Policy Commission of the American Bankers Association placed its finger unequivocally upon the excessive number of banks as "more responsible than any other factor for the banking disasters of the subsequent years."[8] It failed to discern in branch banking the specific against these failures. The remedy suggested had a much more direct and logical relation to the cause. If the failures are due to an excessive number of

[7] *Annual Report of Comptroller of Currency,* 1929, p 2

[8] *American Bankers Association Journal,* November, 1927, p. 305.

banks the apparent remedy is to reduce that number. Something may be accomplished by amalgamations and the conversion of independent banks into branches but the principal objective of reform should be a reduction in the number of charters granted. A complementary and supporting provision would be an increase in the capital requirements of banks.

Inadequate Capital as a Cause

In a number of the states, e.g., Tennessee and Arizona, banking is conducted under the general corporation laws which means practically that there is no minimum capital requirement.[9] In the year 1929 the state of Tennessee had eight banks with less than $10,000 capital. One of these banks had a capital of $5,000.[10] After such a bank purchases its minimum office equipment and pays the expenses of organization, how much margin of safety does the depositor have?

Capital as a Safety Factor

When engineers build bridges they provide a safety factor. They build the bridge to sustain all the weight which can ever be placed upon it multiplied by two, three or four. The normal assets of a bank are equal to its normal liabilities. If no

[9] *Rand McNally Bankers Directory,* July, 1929, p 2344
[10] *Ibid*, Tennessee, et passim

losses are incurred the loans when repaid will meet all deposits. The capital in addition to providing the physical plant within which the bank operates should also be a safety factor. It is idle to expect a bank with a capital of $10,000 or even $25,000 to withstand the strain of a general depression, of occupational distress or the collapse of local booms. Good management and ample business will of course mitigate such dangers but both conditions are the consequence of restricted bank charters.

Size and Safety

From the case against the unit bank it may be gathered that the small bank is particularly susceptible to failure and that the large institution, by no other virtue than its size, is, comparatively speaking, immune. Much is made of the extended field of interest of the great bank, the diversification of its commitments, the facility with which reserve funds may be mobilized at the point of danger and the genius of its management. This notion needs a bit of debunking. We are prone to forget.

Unfortunately, the scintillating mental qualities which place in the hands of great bankers the baton of leadership are frequently coupled with speculative instincts which lead their institutions to the grave of bankruptcy as often as stupidity and peculation undermine the smaller bank.

Failures of Great Banks—Australia

We have been regaled at length with the exemplary record of the Canadian banks in the matter of failures. Let us glance at another colony of Great Britain in which branch banking and large scale banking had followed lines similar to those in Canada. When the year 1893 broke there were 21 banks with hundreds of branches in Australia. When that year closed 14 of these banks with all their branches,[11] including the largest, had failed. There was no inflation of the note issues and the commentators agree in attributing the crash to bad banking.[12] These banks showed discounts and advances in excess of deposits which means that they had practically no secondary reserves of liquid securities. They had tied themselves up in mortgage advances which turned into frozen assets. They had speculated heavily in land. When a suspicious phalanx of depositors charged the banks and demanded payment it could not be done. The banks of Australia, fortified with an elaborate branch organization, registered in a single year a mortality rate of 66 2/3 per cent. Our unit banks with all their shortcomings have never turned in such a performance.

[11] Conant, Charles A., *History of Modern Banks of Issue*, p 544.
[12] *Ibid.*, pp. 543-547.

American

It is also necessary to recall that the panic of 1907 was precipitated by the Knickerbocker Trust,[13] hardly to be classified as a little country bank from the great open spaces. An autopsy revealed that this great institution with its superb management had become involved in the promotion of copper securities. Apparently great bankers can sink their foundations into sand just as fatuously as the humbler members of the fraternity. Moreover, when such a bank fails it undermines the confidence of every depositor in the land The effects are far-reaching and extremely distressing. The failures of our small banks have been annoying to say the least but altogether they can hardly be classified as a major crisis.

Italian

At the end of the war the banking business of Italy was conducted practically by four great banks known as the "Big Four." They had elaborate branch organizations and brilliant management.[14] They could shift funds from places of redundance to areas of scarcity with a dispatch that would warm the heart of any present-day advocate of branch banking. Their assets showed a diversification which would put the average investment

[13] White, Horace, *Money and Banking, 5th edition*, p. 411.
[14] Olson, J. C, *Consolidated Position of Italian Postwar Banking Structure*, Commerce Reports, February 24, 1930, p 501

trust to shame. They served big business in that big way which is not open to our restricted unit banks. Then Jove tossed his bolt from the unsuspected blue. The Banca Italiana di Sconto failed at the end of 1921. The verdict was excessive speculation in trade and industry.[15] At the same time another of the four horsemen of Italian banking found himself in such serious straits that the state had to bring succor. It created another bank for the sole purpose of discounting the "frozen" assets of these two stricken institutions. Two banks out of four make a batting average of .500 Can our much maligned little unit banks equal that score?

Japan

More recently (1927) we find the banking system of Japan in major difficulties. The Peers Bank, one of Japan's largest and most reputable institutions, failed. It had consummated a number of amalgamations with units which could not be assimilated.[16] The imprudent haste in matrimony created discord. The bank had also become involved in top-heavy commitments in steamship, utility and industrial projects. They did not fulfill the promise of their supporters. That sometimes happens even when the penetrating and lucid rays

[15] Commission of Gold and Silver Inquiry, U S Senate, *Foreign Currency and Exchange Investigation*, Vol I, pp 165-166

[16] Department of Commerce, Bulletin No 653, *The Big Five in Japanese Banking*, p 5

of that ineffable intelligence which presumably guides great banks is turned upon them. A number of other leading banks in Japan found themselves so embarrassed at this time that they would have closed their doors had not the state intervened with a moratorium.[17] As in Italy the government established an independent bank to take over the assets of the failed banks and among other things found them cluttered with profitless branches.

Exaltation of Superior Management

The managements of the world's great banks have proven fallible even as the management of the smaller banks. We do not contend for the parity of the two types. By and large it can be conceded quite readily that the larger banks can afford and in fact do have more skillful and more intelligent management than the small banks. In pleading for branch banks on the ground that superior management will relieve us of the perils of failure we are casting a halo about that management which, in the light of experience, it does not merit. Failures may be reduced. When they occur the consequences will bear a gravity which does not attach to the failure of small banks.

Joint Stock Land Banks

In our own country it is probable that no grosser examples of inept management and crimi-

[17] *Ibid*, p. 6.

nal misapplication can be found than in some of our joint stock land banks, none of which can be placed in the category of small country banks. The law requires a minimum capital of $250,000 for these banks. They possess the extraordinary privilege of raising funds through the sale of tax-exempt securities. They are under the supervision of the Federal Farm Loan Board.[18] Three of them, including one of the largest, are in the hands of receivers.[19] The bonds of a dozen of these banks are selling at a shocking discount. In these cases it is possible for us to raise the cover that usually conceals the inner tale of failure and examine the odious record of fraud, deception, speculation and peculation, the infamous manifestation of "superior" bank management.[20]

Kansas City Joint Stock Land Bank

We have had the vices of the small bank, particularly on the score of management, rubbed in so persistently that we must pause for a moment to examine one of the larger banks which has slipped. Our clinical case will be the Kansas City Joint Stock Land Bank. This institution had sold $44,000,000 of tax-exempt bonds,[21] "the instrumen-

[18] *The Federal Farm Loan Act,* Treasury Department, Circular No. 20.
[19] *Annual Report of the Federal Farm Loan Board,* 1927, p 2.
[20] Due to detailed reports of receivers and attention devoted to these banks in annual reports of the Federal Farm Loan Board
[21] *Annual Report of the Federal Farm Loan Board,* 1927, p 63.

talities of the government," to approximately ten thousand investors scattered throughout every state of the Union, Canada, Mexico and a number of foreign countries.[22] The market to-day appraises these bonds at $46 which may be compared with the average return of approximately $90 which the depositor in insolvent national banks realized over a period of years on a similar claim. At the time of failure (May 4, 1927) this bank had capital stock outstanding of $3,800,000. Presumably that represented capital paid in. The accounting sleuths of the receiver were never able to discover any of this capital. According to the confession of some of the borrowers they usually applied for ten per cent. more than they received, the said ten per cent. constituting a subscription to the capital stock of the bank.[23]

Like the Augean Stables

The firm of expert accountants employed by the Federal Farm Loan Board to disclose the condition of this bank required eighteen months to make their first audit.[24] There were literally thousands of accounts so obscure as to defy the inquisitive processes of the examiner. The former head of this bank is a gentleman named Walter Cravens whom a criminal court has invited to become a

[22] Statement of General Counsel of Federal Farm Loan Board
[23] Statement of Chief Examiner of Federal Farm Loan Board.
[24] First Report made February 28, 1929

guest of the government for a period of nine years. Mr. Cravens in addition to being the president of the Kansas City Joint Stock Bank had the distinction of occupying a similar position in four other companies whose activities interlocked in devious and obscure manner with those of the bank. The roster of the directorates of these associated companies was loaded with the various members of the Cravens family.[25]

Purifying the Balance Sheet

One of the companies, known as the Farmers Fund, Inc., may be considered the balance sheet purifier of the bank. No bank likes to carry a heavy item representing forfeited real estate. That would be a reflection on the soundness of the original loans. Mr. Cravens appreciated the value of good appearance. Hence the organization of Farmers Fund, Inc. This company obligingly assumed title to all the real estate acquired in foreclosure and issued a straw mortgage to the bank for the full amount of the original loan whether the land was worth that much or not. This enabled the bank to present a remarkably clean statement.

Developing Kansas

Having the future of the great commonwealth of Kansas at heart the dynamic Mr. Cravens

[25] This account is based upon the published Report of H M Langworthy, Receiver of Kansas City Joint Stock Land Bank, February 28, 1929

would never rest content within the straitened confines of a joint stock land bank. Magnificent aspirations stirred in his breast. He wished to develop the great power resources of the state. Immediately another corporate child, The Missouri Hydro-Electric Power Company, sprang full-grown from the mind of this financial Jupiter. Of course, some manipulation of the assets of the bank was necessary to accomplish this but for the facile genius of Cravens this was all in the day's work.

In Which a Land Mortgage Bank Borrows from an Insurance Company

The receiver noted on the books of the bank an investment in a twelve-story office building carried at more than $900,000. He found that a life insurance company held a mortgage of approximately half this amount on the structure. It is something in the nature of an anomaly to find a financial institution engaged principally in the business of granting mortgage loans on real estate borrowing on its own property from an insurance company. Mr. Cravens and his associates, realizing that the same thought might strike an examiner, considerately omitted to make any mention of this liability in the books of the bank. In accordance with this unique system of accounting there was not a trace of certain important assets which the bank was known to own. Baffled auditors con-

tended for months with obscurities, omissions and deliberate falsifications in the books of this bank. Through it all we find Mr. Cravens with the aid of complaisant satellites making contracts with himself in his various capacities, the modest profits of which contributed to the sustenance of Mr. Cravens.

An Odious Tale

And that explains the price of Kansas City Joint Stock bonds. Here is a bank playing Twentieth Century versions of all the old frauds, no capital, false entries, vital omissions, contracts between the right and left hands of the same official —the moss-covered and sinister tale runs its course. Here is a great bank by every test. Its operations covered several states. It had ample "capital." The Federal government chartered and supervised it. Privileged access to the capital market of the country was granted and used to the extent of many millions. Neither honesty nor competence was found in the high seat of its management.

Safety of the Canadian System

It is very gratifying to the student of American banking concentration to be able to look across the northern border and observe in a neighboring country the reflection of those future conditions which will prevail in this country should the present trend of banking continue. Conditions in the two

countries are sufficiently similar to permit a comparison. The fact has emboldened the friends of concentration to point to the apparent safety of the Canadian system with convincing finality. The banks of Canada do not fail by the thousand. Canadian depositors do not suffer losses. Branch organization and greater size are the answer. Let us look into this.

The records reveal only one failure in the last fifteen years Before examining this phenomenon we might admit a little light on the reason for that single failure. Bankers rarely take the public into their confidence in such matters and the man in the street must usually rest content with the fact of failure. However, in the case of the Merchant's Bank we find Sir Edmund Walker, president of the Canadian Bank of Commerce, on the stand before a Parliamentary Committee, catechised as to the cause of failure. He finally conceded with obvious reluctance that "It failed apparently through lending money to a stock exchange house upon securities that it should not at any time have lent a large sum of money on. . . ."[26]

We have indicated above that the superficial record of safety of the Canadian banking system may lead to false conclusions as to the relative safety of branch and unit systems. We have seen

[26] *Proceedings of Select Standing Committee on Banking and Commerce of the House of Commons,* Canada, 1923, pp. 532-533.

that other countries with branch systems have had their fair share of troubles and that the formula of organization which we are seeking to apply in our own country failed to reveal any magic qualities.

Deceptive Nature of Canadian Record

The Canadians had observed the tide of banking consolidation taking place in their own country with a measure of uneasiness which finally led to the inclusion of certain restrictions in the Bank Act of 1923 (sections 99-111). These called for the consent of the Governor-in-Council based upon the recommendations of the Minister of Finance and the Receiver General before a merger could take place. Since Canada has a representative government which reflects popular wishes and popular fears as effectively as our own it can be taken for granted that no mergers would be permitted unless such a step were considered the lesser of two evils and could be defended before a hostile parliament. Since the passage of this act there have been six mergers. It is singular that in every case the amalgamation was made necessary by the impending failure of one of the banks.[27] The motive, therefore, has been less a desire to realize the putative profits of monopoly or the economies of integration than the stark necessity of self-

[27] See *House of Commons Debates*, June 20, 1923, pp 4135-4139, and *Proceedings of Select Standing Committee*, 1923, *op cit*, p 893

Comparative Safety of American and Canadian Banks

United States

Year ended June 30	Number	Liabilities of failed banks (000 omitted)	Total individual deposits of all banks (000 omitted)	Ratio of liabilities of failed banks to liabilities of all banks Per cent
1900	41	17,774	7,238,986	0.246
01	57	19,865	8,460,642	0 235
02	47	10,671	9,104,723	0.117
03	31	7,394	9,553,694	0.077
04	126	37,268	10,000,547	0.373
05	74	14,933	11,350,739	0.132
06	51	14,672	12,215,768	0.120
07	38	24,095	13,099,635	0.184
08	153	226,452	12,784,511	1 771
09	75	29,877	14,108,039	0 212
10	34	29,751	15,283,396	0 195
11	59	20,994	15,906,275	0 132
12	63	16,572	17,024,068	0.097
13	45	10,496	17,279,059	0.061
14	117	41,833	18,317,613	0.228
15	124	40,633	18,969,900	0 214
16	54	19,030	22,554,685	0 084
17	42	16,582	26,062,987	0.064
18	27	12,617	27,748,471	0.045
19	43	10,107	32,665,286	0 031
20	49	20,885	37,315,123	0.056
21	358	113,425	34,844,572	0.326
22	397	116,220	37,194,318	0.312
23	274	84,626	40,034,195	0 211
24	915	297,931	42,954,121	0.694
25	542	172,043	46,765,942	0.368
26	573	186,935	48,882,296	0 382
27	831	366,570	51,062,100	0.718
28	484	158,689	53,244,700	0.298

CANADA

Year	Number	Liabilities of failed banks[28]	Liabilities to public of all banks in Canada[29]	Ratio of liabilities of failed bank to liabilities of all banks Per cent.
1900	0		356,394,095	
01	0		420,003,743	
02	0		466,963,829	
03	0		507,527,550	
04	0		554,014,076	
05	1	388,660	618,678,633	0.063
06	1	15,272,271	713,790,553	2.140
07	0		769,026,924	
08	3	17,907,819	762,077,184	2.350
09	0		882,598,547	
10	2	2,546,871	1,019,177,601	0.250
11	0		1,097,661,393	
12	0		1,240,124,354	
13	0		1,287,372,534	
14	1	912,137	1,309,944,006	0.070
15	0		1,353,629,123	
16	0		1,596,905,337	
17	0		1,866,228,236	
18	0		2,184,359,820	
19	0		2,495,582,568	
20	0		2,784,068,698	
21	0		2,556,454,190	
22	0		2,364,822,657	
23	1	24,889,049	2,374,308,376	1.048
24	0		2,438,771,001	
25	0		2,532,832,064	
26	0		2,604,601,786	
27	0		2,758,324,713	
28	0			

[28] *Canada Year Book*, 1927-28, p 878
[29] *Ibid*, p 866.

preservation. At the end of 1922 Canada had 18 banks. Today she has eleven.[30] That indicates a casualty list of 7 banks. This represents a mortality rate of 39 per cent. Whereupon we may contemplate the frailties of unit banking with less embarrassment and greater composure.

Sugar Coated Suicide

A careful student of Canadian banking [31] intimates that rivalry of the great banks not only created competitive conditions which forced the weaker banks to lean on the stronger for support but also created a favorable market in which the banks facing failure could sell their assets to advantage. The personal ambitions of the leaders striving for greater units under their control made the prospect of ruin for the weaker banks not altogether unattractive. This may have contributed a certain complaisance in the face of extinction to those banks whom competitive circumstances forced to walk the plank.

Mutual Responsibility

So close is the fraternity of interest in a limited group of banks that it is practically necessary for the stronger banks to take over those which are in

[30] Including the Canadian affiliate of Barclays Without this there are only the chartered banks which increases the casualty list to 8

[31] Willis and Beckhart, *Foreign Banking Systems*, p 341

danger of failing If one bank should fail with resulting losses to depositors it would so undermine that foundation of public confidence in which alone banks can thrive that it would jeopardize the existence of the remaining banks. In our own country in 1907 the Trust Company of America was not permitted to close its doors. Although technically insolvent it was aided by stronger banks, the depositors were protected and the confidence of the public in the banks of the community was maintained insofar as it was possible to maintain it in those dark days.[32] The banks of Canada realize their own self-interest no less thoroughly than American institutions. One Finance Minister went so far as to say that even without the sanction of law he could compel operating and solvent banks to take over the assets and liabilities of a bank on the brink of failure.[33]

On Beautiful Analyses

The evidence so far may justify the conclusion that it is an error to entertain any illusions of infallibility of large scale banking. Turn now to the small bank. Is it true as the Comptroller would have us believe that small unit banking is as unsafe as large scale banking was presumed to be safe? All the arguments which were employed to estab-

[32] White, Horace, *Money and Banking,* Fifth edition, p 411

[33] Thomas White, *Royal Commission to Inquire into the Report upon Affairs of the Home Bank of Canada,* p 359

lish the safety of the latter may now be turned against the small bank. It has limited strength. Its vision is straitened. Its management is mediocre. Its eggs are all in one basket. It must pass through the chills and fevers of scarce and redundant local credit supply. On the surface and in the face of this analysis the small bank gives excellent promise of an early grave. However, it is known that some of the most beautiful analyses have been blighted by exposure to relentless facts. Let us try that test.

Classifying the Banks—Big Banks

The author has established four distinct groups of banks. The first group consists of banks in New York, Los Angeles and San Francico, 35 in number. Los Angeles and San Francisco have been selected rather than Chicago and Philadelphia partly because the State of California has for some time viewed bank concentration and the branch organization with tolerance and also because the classification of earnings and expenses of banks reported by the Comptroller favored the inclusion of the two western cities. These 35 banks have an average capital and surplus of $24,162,000. Eleven of the 35 have an average capital and surplus in excess of $75,000,000 and hold more than 92 per cent. of the capital funds of the group The conclusions which may be drawn from this group may

be regarded therefore as truly representative of the great bank.

Medium Size Banks

The second group consists of 113 medium size city banks with an average capital and surplus of $2,535,000. These banks are approximately one-thirtieth the size of the mammoth institutions in the first group. The cities in which these banks operate are located in all parts of the United States. The conclusions may be regarded as representative of this type of substantial independent urban bank.

Small Country Banks

The third group consists of 1340 small country banks with average capital and surplus of $267,900 located in eleven different states representing every section of the country. The capital funds of this host of small banks are not equal to the capital funds of two of our banks in the first group, the National City Bank and the Chase National Bank of the City of New York. Although this third group was selected from states in which bank failures have been comparatively low during the last nine years, they nevertheless include all the country banks from such states as Virginia, Alabama, Kentucky, Nevada and California. They constitute our typical small country banks

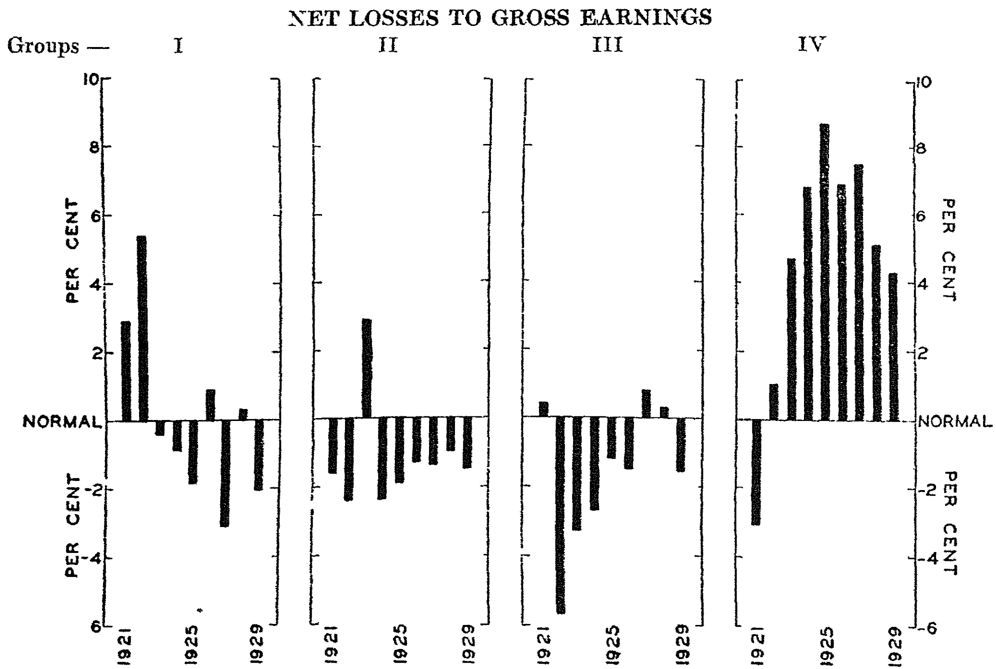

CHART I

The normal line is the average for all national banks in the United States Percentage is of gross earnings Basic data are taken from the annual reports of the Comptroller of the Currency

selected from regions which have not been overwhelmed by agricultural depression.

Small Country Banks in Distress Areas

Our fourth group contains 2309 country banks with average capital and surplus of $107,000 located in 12 states which have borne the brunt of regional distress during the past nine years.

Source of Data

These banks are all national banks and the data from which the ratios have been calculated are taken from the annual reports of the Comptroller of the Currency. We have established twelve more or less significant ratios of various income and expense items for these banks by cities, states and groups and for each of the nine years in the period 1921-1929. In the present chapter we shall confine ourselves to the ratio of net losses to gross earnings. Since the issue lies between the safety of large scale branch banking and small scale unit banking what has been the experience of the banks in the first group as compared to the banks in the third group?

The Verdict

The chart indicates the statistical verdict in graphic form. It will be seen that the big banks have suffered losses above the normal in four of the nine years as compared to three years of super-

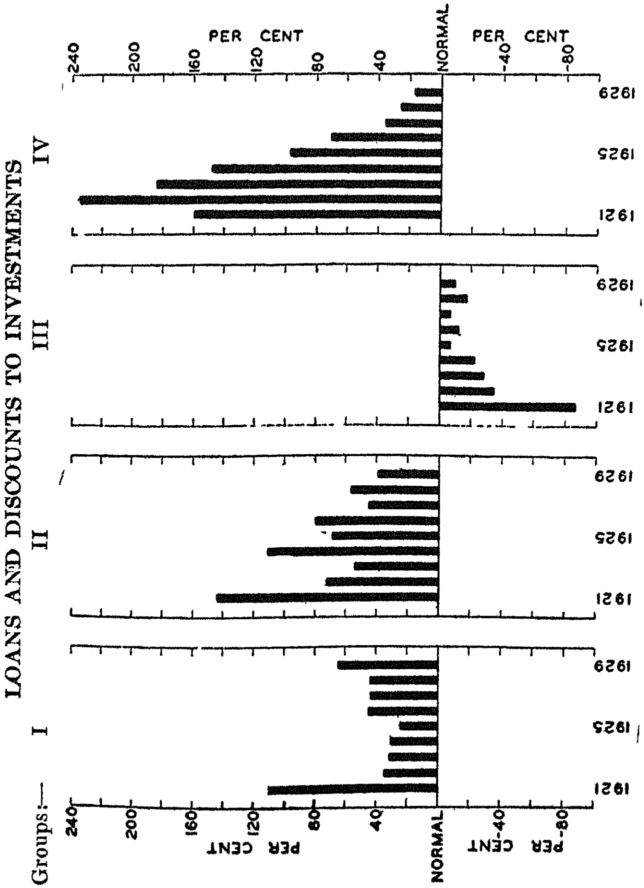

CHART II

The normal line is the average of all national banks in the United States. Percentage is of investments. Basic data are taken from the annual reports of the Comptroller of the Currency

normal losses for the small country banks. Furthermore, the great banks were smitten much more seriously by the post-war depression than the small banks. In 1922, for example, the net losses of the latter equalled 8.4 per cent. of gross

earnings as compared to 19.5 per cent. for the titanic city institutions. In that year the national banks of San Francisco showed losses equal to 28 per cent. of gross earnings which was exceeded only by the country banks of Nevada in 1923 and the country banks of Montana in 1924. Although the banks of Los Angeles have an excellent record of losses for this period, with an average of only 7.6 per cent., it is not quite as good as that which the country banks of Kentucky can show with 7.1 per cent.

Balance Sheet Records

It will be of some value in this connection to examine the balance sheets of great and small banks. The evidence while not as conclusive as that of actually recorded losses nevertheless reveals inherent probabilities. This procedure has the additional advantage of permitting us to include in the comparison English and Canadian banks.

Capital Safeguards

One of the greatest safeguards of the depositor is the capital which the proprietors of the bank invest in the business. It is their hostage to prudence and is to the depositor what a safety factor is to a physical structure. It serves to care for excessive strains which it is known will occur but which cannot be forecasted with even approxi-

mate precision. It may be said of the banking business that *other things being equal* that bank is the safest which has the greatest ratio of capital funds to deposits, or, the lowest ratio of deposits

RATIO OF TOTAL DEPOSITS TO CAPITAL AND SURPLUS

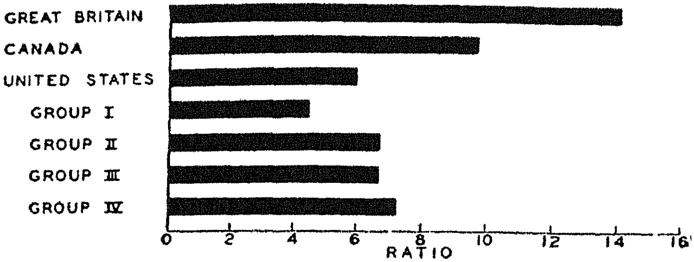

CHART III

Great Britain—"Big Five"	13 96 to 1
Canada—Ten Chartered Banks	9 68 to 1
United States—National Banks	5 98 to 1
Group I—Big Banks .	4 50 to 1
Group II—Medium Size Banks	6 66 to 1
Group III—Small Country Banks	6 65 to 1
Group IV—Small Country Banks in Distress Areas	7 23 to 1

to capital funds. It will be noticed (see Balance Sheet charts and tables) that the banks of New York City are at the bottom of the list with a ratio of total deposits to capital and surplus of 3.64 to 1. The branch systems of California are well above the average for the country as a whole. That may be interpreted either as economy of capital or sacrifice of safety. In fact the small country banks in distress areas where most of our bank

failures have taken place show the smallest margin of protection to the depositor among the American banks. The positions of the Canadian chartered banks and the "Big Five" of England present an unfavorable contrast. The British banks show approximately one dollar of capital funds to

RATIO OF TOTAL DEPOSITS TO CASH AND RESERVES

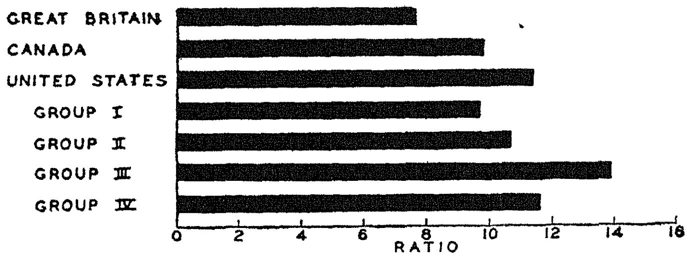

CHART IV

Great Britain—"Big Five" .	7 74 to 1
Canada—Ten Chartered Banks	9 84 to 1
United States—National Banks	11 44 to 1
Group I—Big Banks	9 72 to 1
Group II—Medium Size Banks	10 74 to 1
Group III—Small Country Banks .	13 88 to 1
Group IV—Small Country Banks in Distress Areas	11 58 to 1

fourteen dollars of depositor's funds. The Canadian banks have a safety factor slightly exceeding ten per cent.

Cash and Reserves an Assurance of Liquidity

Cash and reserves constitute an assurance of liquidity rather than safety although liquidity is in itself a phase of safety. The branch systems of England and Canada make an excellent showing

in their cash position although the greater use of currency in these two countries on the one hand and the supporting position of the reserve banks in this country on the other make a comparison rather difficult. The figures do indicate that within the United States the small banks enjoy a distinct advantage as compared to the big banks in the amount of non-earning liquid reserves which they find necessary. The ratio is possibly of greater significance in a comparison of the economies of the two types of banking than in their relative safety. For we may say that *other things being equal* that bank which can operate with the least cash and reserves will show the greatest earnings.

Dissipation of Safety on Premises

In the matter of bank premises we again are dealing with a fact fully as important in the field of bank economy as in the field of bank safety. It bears upon the former in that capital invested in plant is non-productive in the income sheet sense. It is a non-earning asset. It bears upon safety in that the capital so invested reduces by that much the funds which are intended to safeguard deposits. Here we find the great branch systems serving a wide area and the small country banks suffering by comparison with the banks of New York City. The latter employ but 8 per cent. of their capital and surplus for bank premises.

The banks of Los Angeles have sunk 36 per cent. of their capital funds in buildings and San Francisco 28 per cent. The returns from the latter two cities are dominated by state wide branch systems. An examination of the detailed returns shows

PERCENTAGE BANK PREMISES OF CAPITAL AND SURPLUS

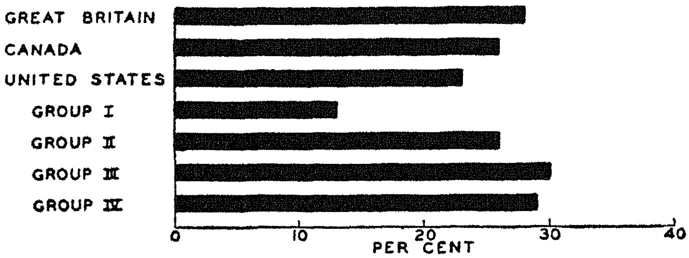

CHART V

Great Britain—"Big Five"	28 per cent
Canada—Ten Chartered Banks	26 " "
United States—National Banks	23 " "
Group I—Big Banks	13 " "
Group II—Medium Size Banks	26 " "
Group III—Small Country Banks	30 " "
Group IV—Small Country Banks in Distress Areas	29 " "

marked variations within each group which deprives generalizations of the significance which they might otherwise have. Outside of New York City the great banks do not appear to have any advantage over the small banks in this matter.

Earning Assets Versus Liabilities

Where a bank has inadequate funds it is necessary to devote a part of the deposits to the mainte-

nance of non-earning assets such as reserves, cash and premises. The relationship of total loans and discounts plus investments is highly significant. In the British banks we find that only 86 per cent. of their clients' funds are on the job earning income.

PERCENTAGE LOANS AND DISCOUNTS OF TOTAL DEPOSITS

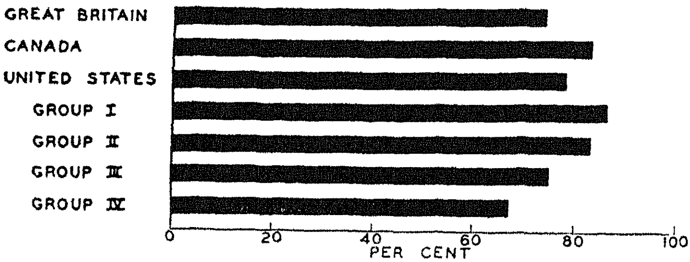

CHART VI

Great Britain—"Big Five"	74 per cent.
Canada—Ten Chartered Banks	83 " "
United States—National Banks	78 " "
Group I—Big Banks .	86 " "
Group II—Medium Size Banks	83 " "
Group III—Small Country Banks	75 " "
Group IV—Small Country Banks in Distress Areas	67 " "

In other words if these banks should sell all their securities and call in all their loans they could pay only 86 cents on the dollar to their depositors.[34] This is hardly a healthy condition and appears less so by comparison. With the Canadian banks the total of earning assets rises to 100 per cent. The

[34] This does not take into account cash and reserves In the case of the English banks this would just enable them to meet their deposit claims

evidences of indebtedness held by the New York banks are equal to 122 per cent. of the amount due to other banks, the government and the public. We may say of these banks that they have matched their obligations to others by an equal amount due to them, have provided a safety factor of 22 per

PERCENTAGE INVESTMENTS OF TOTAL DEPOSITS

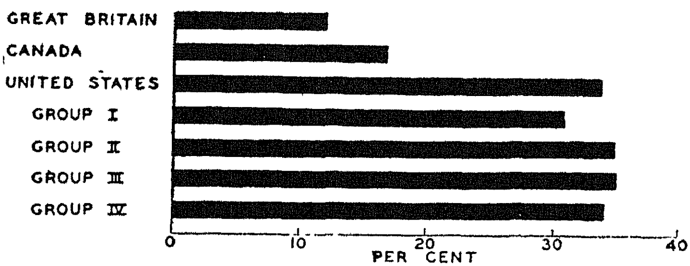

CHART VII

Great Britain—"Big Five"	12 per cent
Canada—Ten Chartered Banks	17 " "
United States—National Banks	34 " "
Groups I—Big Banks	31 " "
Group II—Medium Size Banks	35 " "
Group III—Small Country Banks	35 " "
Group IV—Small Country Banks in Distress Areas	34 " "

cent. and on top of that own their premises. In the first three American groups there is a comfortable margin between the sum of loans, discounts and investments on the one hand and total deposits on the other.

A Doubtful Remedy

The picture of thousands of small banks which

have failed, and the prospect of other thousands yet to fail, has been invoked to justify the extension of branch banking. The present Comptroller speaks on behalf of the depositor. It must be clear, however, that no change in bank structure can possibly help the clients of banks which have already failed. Their losses must be considered as so much spilt milk. The protective character of large scale banking must therefore find justification in the assurance which it can give to the depositors of unit banks of dubious strength which are still in the field. How can greater statutory latitude in the matter of branch organization protect deposits now in peril? Only if our great banks, which presumably will take immediate advantage of their new privilege, undertake to incorporate the weak institutions in their systems. This becomes plausible if we postulate philanthropy as the principal objective of the banking business. If such a premise is untenable and we accept the more probable premise of maximum private profit, then we must look in vain for any greater protection in the near future to those thousands of depositors whose accounts now stand in peril. Weak unit banks are the very last which a great multiple bank alive to profit prospects will acquire. Only through the incorporation of such frail units will our banking structure as a whole gain in safety.

Selective Admission to Groups and Chains

It has been a common experience among the bankers promoting chains and greater branch systems that many banks apply for admission and that few are chosen. These men very naturally are careful not to acquire any units which may embarrass the group. The fact of discriminating selection is adduced by the champions of group banking as an argument in their favor. Trevor O. Hammond, vice-president of the National Bank of Montana, spokesman for group banking in the Northwest states, says "I do know that only banks of the highest standing and of a known and long record for integrity, success and earning power, have been invited to affiliate in this new movement.[37]

Two Stages of Concentration Movement

We have here a distinct contrast with the Canadian practice and that in other countries where recent amalgamations have taken place in a group whose members were already the fruit of a long prior amalgamation process. Our strong banks have no responsibility for their weaker brethren. The concentration movement is still in that stage where the centripetal elements may move of their own accord. Strong banks are joining strong banks. The weak banks are left out in the cold.

[37] *American Bankers Association Journal,* October, 1929, p 28

How this process can afford added protection to the depositors of the latter is not clear.

Conclusion—Size Not the Formula of Safety

Our conclusion then on the mooted question of safety is this. Even as it has not been established that great banks are impregnable towers of strength to which the depositor may commit his savings with complete assurance, even so, has it not been established that small banks are frail reeds which the wary depositor should avoid. In both cases must he take note of the individual bank, the great no less than the humble. The simple formula of size is a treacherous substitute for discretion.

CHAPTER VII

PROFITS

THE LEGISLATOR looks at concentration through eyes that measure the general welfare implications of the movement. He is the elected and paid defender of the public interest and the test he applies to any problem demanding attention differs radically from the test which an observer with a proprietary interest would apply. The former emphasizes public welfare, the latter private profit. At times the two are diametrically opposed. This, fortunately, does not appear to be the case with the changes which are now taking place in American banking.

Banking concentration presents many attractions of an abstract character to the investor, attractions which bear excellent promise of subsequent conversion into the more material substance of income. To illustrate this a few preliminary, elementary observations are necessary.

Sale of Credit Chief Source of Bank Income

The commercial bank earns an income by the sale of its highly liquid, non-interest-bearing credit for the less liquid interest-bearing credit of the

customer. In other words, the bank accepts the client's note for $100 with interest and gives him the right to demand payment of a similar amount without interest. Now, if it were invariably the case that the client withdrew the proceeds of his loan in hard cash at once the business of banking would hardly be profitable. In that case the credit power of the bank would coincide with the actual cash in its possession. Thus the bank would have no advantage whatsoever over any private citizen. It would be selling no credit at all but merely lending money. The profits of banking arise from the ability of the bank to lend, in a sense, something which it does not have. If a bank with $1,000 of real cash lends $10,000 to its clients it is obviously selling what it does not possess in the concrete. Should these clients all demand payment at the same time or if any substantial portion of them should demand payment at the same time, the bank would have to confess an inability to respond. Every bank faces this hazard and its appearance invariably spells insolvency unless the bank can secure reinforcements.

Ratio of Credit to Cash

It will be seen that the greater the ratio of credit outstanding to cash and the less frequently the clients demand payment the greater the profit of the bank, assuming equal good fortune in the

appraisal of credit risks. Every bank, therefore, seeks to conduct its business in such a fashion that the right to demand immediate payment, sold to its clients, will in fact not be exercised. Our early pre-Civil War banks issued circulating notes which were merely negotiable deposit slips payable on demand. They correspond to the checks in use today. These primitive bankers were very direct in their efforts to prevent the presentation of the obligations which they had sold. The notes were issued in distant communities and every obstacle placed in the path of redemption. Such efforts cannot very well be tolerated today. Yet the banker of today strives constantly to achieve the same end through means which in some cases do not restrict the rights of the depositor at all and in other cases only mildly as compared to the methods of his professional progenitors.

Devices to Protect Cash

When the banker insists upon the maintenance of a minimum deposit which bears a definite relation to the amount of a loan he is merely assuring himself against the exercise of those rights of the depositor which will impair his profit. When the banker seeks to encourage local enterprise and when he assumes those many related functions which constitute integrated banking he is merely striving to effect in a more refined and less in-

equitable fashion those same ends which motivated his predecessors.

As Applied to Local Projects

Consider the encouragement of local enterprise through local banking policy. A builder comes to the banker with a proposal to develop Lovely Gardens. Provided it is sound the financing of this project will be much more attractive to the banker than the purchase of an equivalent amount of commercial paper in the Big City. If he elects the latter course he knows that he will shortly have to furnish cash equal to the investment. If he embraces the former opportunity the course of credit realization is entirely different. The proceeds of the loans to the builder are left on deposit. As they are reduced to pay the local masons, carpenters, plumbers and hardware and material dealers a substantial part of the checks find their way back into the bank with the net result that the banker merely transfers the right to demand payment from the builder to other clients. He thus successfully reduces the inroads upon his cash. He loses only that portion of the loan which leaves the community for material or services produced elsewhere.

The Balance of Payments

As these outside checks return to him for payment he must meet the demand from one of two

sources. He, the local banker, is also the recipient of checks drawn on other banks which in the course of the business day are presented to him by his own clients. These checks on other banks are an offset to his own checks which find their way into other communities. If the two balance he is just as well off as though all the checks had been exchanged among his own clients. This happy event is only partly realized. When he reckons his daily totals of clearances there is usually a balance either for or against him. The settlement takes place in the clearing house. Now his cash reserves come into play. If the balance is against him he must pay out cash. If it is in his favor his cash gains. Often the movements in one direction or another are such as to compel recourse to other expedients. A persistent drain of deposits and its consequent unfavorable clearing balances compels him to resort to his correspondent bank or to his Federal Reserve Bank. An undue accession of deposits causes him to seek some other use for the excess than can be discovered in his own community. While the local banker may guide his lending policies with a view to minimizing these fluctuations his power in this respect is limited. His depositors and borrowers are not altogether identical nor can he always discern the purposes for which a borrower will employ his credit. Fluctuating cash balances, therefore, remain a problem.

Reducing the Strain on Reserves

Here consolidation and branch expansion step in to help the banker. Through both methods the greater bank places itself in a position to catch a larger portion of the backflow of expenditures. By providing banking facilities for an increasing part of the community it reduces the proportion of its credit drafts which first find their way into other banks. In the second place, the service of a wider area brings compensatory movements which the small unit bank does not have. Where the large bank serves a number of communities the outward flow in one may be met by an inward flow in another. The amount of clearings necessary for a system of ten banks is far less than the clearings of a similar number of independent banks. This is merely another illustration of the principle of diversification in which the credit drains of one bank or group of banks in a system are counterbalanced by the gains of another group.

Decreases Necessary Capital and Reserves

Such an arrangement not only decreases the occasions on which it is necessary for the system to resort to its cash reserves but reduces the extent to which inroads must be made. As a result we have a definite economy in large scale banking which finds reflection in two significant bank items. There is a reduction in the capital necessary for safe bank-

ing in relation to a given amount of liabilities and a similar reduction in the reserves required to assure payment of demands. From the standpoint of bank profits both economies are important. It can be stated as a rule of banking that other things being equal the greater the ratio of deposit liabilities to bank capital the greater the profits of the bank. Since cash reserves are idle bank merchandise which brings no return, it is obvious that a reduction in the amount necessary should increase bank profits.

Why Bank Credit Remains at Home

The relative growth of bank clearings and bank debits in this country during the past ten years shows very clearly the effect of concentration on the interbank flow of credit.

	Bank Clearings [1] 179 Cities Millions	Debits to Individual Accounts 141 Cities Millions
1919	387,854	455,294
1920	460,422	483,026
1921	374,227	399,036
1922	379,211	439,364
1923	408,334	463,726
1924	434,501	491,691
1925	495,785	570,064
1926	525,140	607,956
1927	535,792	673,861
1928	603,687	806,406
1929[2]	713,762	865,527

[1] *Statistical Abstract, U S*, 1929.

[2] Clearings total for 244 cities reporting to New York Clearing House Association taken from *Report of the Comptroller of the Currency,* 1929, p 87. The debit total is taken from the *Federal Reserve Bulletin*

The figures are not strictly comparable since the clearings totals include bank as well as individual clearings in addition to possessing other characteristics which would require correction for a strict comparison. They show that with greater concentration a larger proportion of the deposits withdrawn from banks flow back to the same banks instead of passing through a clearing operation. In fact this point was used as an argument in defence of the great banks of Britain against the complaint that the credit discipline of large-scale banking resulted in a diminution of lending. It was alleged that the "homing" qualities of deposits increased the lending ability of the great bank.[3]

Effect Upon Capital and Reserves in United States, Canada and Great Britain

That this change in the flow of credit has its effect upon the cash reserves necessary to support a given structure of credit as well as upon the capital of the banking system is indicated by the following figures:

	Ratio of deposits to Total Capital	Ratio of deposits to Cash Reserves
United States [4]	6.7	14.1
Canada [5]	9.7	14 0
Great Britain [6]	13.6	5.8

This shows that the American depositor has one dollar of bank capital to protect every $6.70

[3] Sykes, Joseph, *Amalgamation Movement in English Banking*, pp 155-6.

of his deposits whereas that amount of capital suffices for $9.70 in Canada and $13.60 in Great Britain. While this reduced capital margin tends to increase profits it also impairs safety. So serious had this weakness become in Great Britain by 1918 that the Committee on Financial Facilities [7] as well as the Bank Amalgamations Committee [8] sharply criticized the banks for undermining this safeguard of the depositor. How far this had progressed in Canada and Great Britain may be judged from the fact that in 1900 a dollar of capital protected approximately $4.15 of deposits in Canada [9] and $7.53 in England.[10]

Liquidity of Great American Banks

On these two scores the progress of American banking concentration offers an agreeable contrast. Let us take the national banks in our three original central reserve cities, New York, Chicago and St. Louis. In 1914 these banks showed a ratio of deposits to capital of 5.1 and deposits to cash of

[4] June 30, 1927, *Report of the Comptroller of the Currency*, pp 102-3

[5] September 30, 1927, *Ibid*, p 781

[6] December 31, 1927, Department of Commerce, *Banking and Trade Financing in the United Kingdom*, Trade Information Bulletin No 639, 1929, pp 12-13.

[7] Sykes, Joseph, *Amalgamation Movement in English Banking*, *op cit*, p 103

[8] *Report of the Treasury Committee on Bank Amalgamations*, London, March 11, 1918, p 5.

[9] *Canada Year Book*

[10] *Report of Treasury Committee on Bank Amalgamations*, *op cit*, p 5

4.5.[11] In the fall of 1929 these banks, now the result of numerous consolidations and direct growth, had so far improved the position of the depositor as to provide one dollar of capital for every $2.45 of deposits, approximately five and a half times as much capital protection as that afforded the English depositor. In the matter of liquidity the American bank now had one dollar of cash or its equivalent in Federal Reserve credit for every $5.50 which it owed to its own depositors.[12] This is a better cash position than that indicated for the banks of Great Britain since the latter country probably employs cash in the settlement of its business to a greater extent than does our own. English banks would therefore normally require more cash in relation to deposits than American banks.

Strength of American Banks

The emphasis upon the strength of the capital structure which our greater banks are evidently providing is further confirmed by the relation of gross earnings to capital and surplus. In common parlance this may be regarded as the turnover of the bank. Our first group of banks (See Ratio No. 8), the Big Banks, shows a declining ratio for the nine year period, 1921-1929. For our third

[11] *Report of the Comptroller*, 1914, p 34.

[12] *Abstract of Reports of Condition of National Banks*, No 164, Washington, Nov. 11, 1929.

group, the Small Banks, this tendency is reversed. The most convincing evidence is the ratio deposits to capital and surplus. (See Ratio No. 3.)

GROSS EARNINGS TO CAPITAL AND SURPLUS

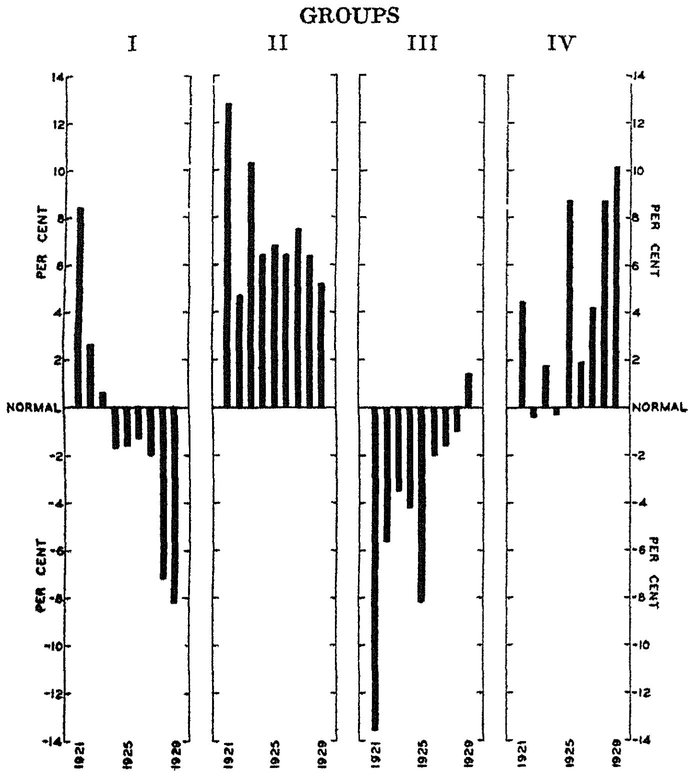

CHART VIII

The normal line is the average of all national banks in the United States Percentage is of capital and surplus Basic data are taken from the annual reports of the Comptroller of the Currency

American Criterion of Bank Strength

Thus our great banks, while apparently permitting their profit prospects to suffer, are determined to maintain their strength. This is the result largely of popular and bank psychology in this country. Our students of banking, the general public and the banks themselves have always emphasized the capital fund of the bank as the institution's hostage to safety. The difference between American and English and Canadian banks in the attitude toward capital is well illustrated by their advertisements. When an English or Canadian bank attempts to convey the impression of strength by a single figure it offers total resources. The American bank in contrast almost invariably emphasizes its capital fund. Here is the Central Hanover Bank and Trust Company concluding a full page ad with the proud assurance "Capital, Surplus and Undivided Profits Over One Hundred Million Dollars." The Bank of Montreal, on the other hand, tells us "Total Assets in Excess of $960,000,000." As a matter of pure pride, our great banks would probably rather enjoy preeminence in capital strength than in the aggregate of assets even though the latter might signify greater income. As a result of the peculiar character of American banking rivalry and an odd twist in banking psychology we find the concentration movement leading our banks in a direction

opposed to private interest in favor of a greater measure of public protection.

To Avoid Final Cash Payment One Purpose of Concentration

From the point of view of credit flow and interflow the object of branch expansion and other

NET ADDITIONS TO PROFITS TO GROSS EARNINGS GROUPS

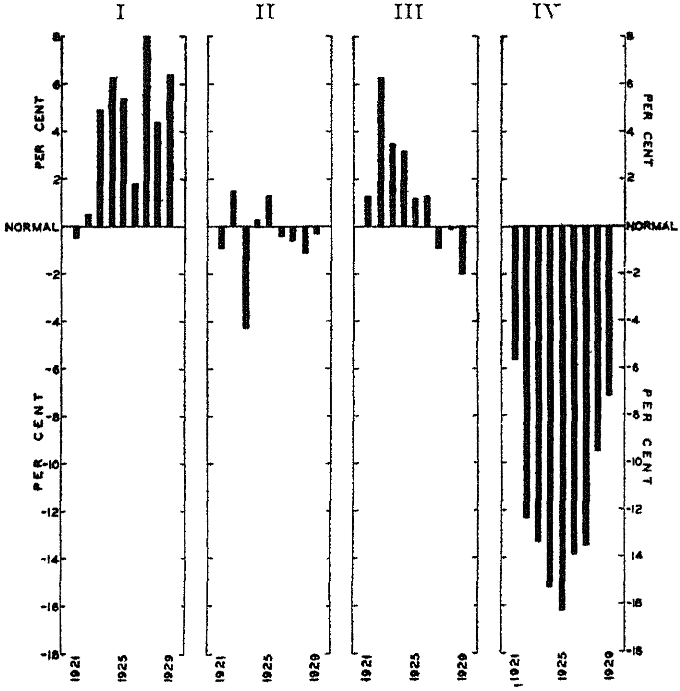

CHART IX

The normal line is the average of all national banks in the United States Percentage is of gross earnings Basic data are taken from the annual reports of the Comptroller of the Currency

forms of affiliation resulting in a broader geographic base and an increased number of offices is to reduce the hazard of heavy demands for payments to the bank's clients, to minimize their effects by the assurance of ample counter receipts in the form of claims on other banks, to safeguard the cash and reduce to a minimum the amount necessary in the conduct of the business. Banking concentration, therefore, seeks to effect in an entirely legitimate fashion that avoidance of final cash payment which our earlier banks sought through the location of issuing banks in the depths of the wilderness.

Facilitates More Complete Credit Expansion

It follows, therefore, that a great bank with many branches can in a period of credit expansion multiply the accommodation which it secures from its Federal Reserve Bank more often than can a unit bank which has no stabilizing credit affiliations. To illustrate. The multiple bank increases the credit granted to its own customers by $1,000,000. As the effective portion of this accommodation is disbursed by the clients a larger portion of it flows back to the bank than if it were a single bank without any subordinate credit nets placed to catch that part of the backflow which starts its return journey in other localities than that in which it was first issued. While the statistical evidence on

INTEREST AND DISCOUNT ON BORROWED MONEY TO GROSS EARNINGS

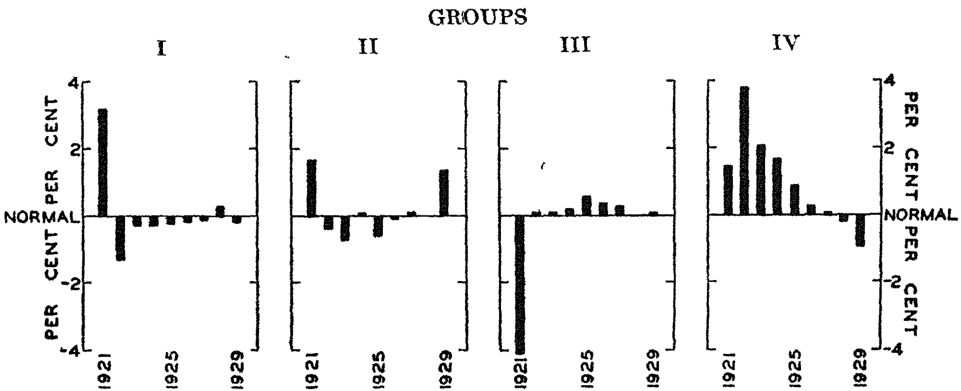

CHART X

The normal line is the average of all national banks in the United States Percentage is of capital and surplus Basic data are taken from the annual reports of the Comptroller of the Currency

this point is not overwhelming it does provide a measure of support. If we examine the ratio "Interest and Discount on Borrowed Money to Gross Earnings" and omit the extraordinary year 1921, we can see that the large banks do not have to resort to the central bank for aid to the same extent as the smaller unit banks. The figures for some of the banks in the third group indicate a constant and heavy dependence upon the central bank. This is particularly true of the country banks of New Hampshire, Virginia and Alabama.

Integration Reduces Drain Upon Bank Funds

Even as physical expansion has for its purpose the capture of the bank's errant credit even so do the various forms of bank integration strive to discourage the departure of bank funds. Consider the sale of securities. The client has accumulated a balance whose reduction investment prudence demands. He goes to his banker. Can he recommend anything? It is costly advice for the banker to give since its acceptance will result in the diminution of a fat account. He swallows hard and reluctantly obliges the customer. This difficulty has been met very nicely by the great bank. It has acquired a security affiliate which devotes its energy to the distribution of securities. Naturally the bank will expect the corporation whose obligations it is selling to retain the proceeds in the bank until they

are used. When the client of the bank now asks for investment advice, it becomes a counsel of pleasure. He is urged to buy a hundred shares of Unico Copper and another hundred of Pan American Utility in the distribution of which the security affiliate is then ardently engaged. The client's account is charged with the amount of his investment and the accounts of Unico Copper Company and Pan American Utility, Inc., are credited with a similar amount minus the commission which is credited to profit and loss of the bank. The client has made his investment. Securities of two other corporate clients have been sold. The departing credit of the investor has been waylaid by the investment counsel of an official and led gently back into the bank and the profits of the bank have been augmented. It is a delightful arrangement.

Helping Our Relatives

Of course the game does not stop here. The two corporations will shortly wish to expend their newly acquired capital and here again the bank will lend a helping hand. Insofar as it is practicable the bank will try to induce the two companies to favor other clients of the bank in their expenditures. The copper company, for example, may wish to purchase some mining equipment. Among the clients of the bank is one who manufactures such equipment. He will be grateful to the bank

for the business which it has sent to him. It will fortify his allegiance and when he receives payment the check will be deposited in the bank on which it is drawn and another attempt of credit to escape will have been nipped in the bud.

The Trust Business

Consider the trust business of a bank. As in the case of security sales the bank receives direct compensation for services performed. Here again is an opportunity to keep accounts in the bank and attract others. A man dies. The bank is appointed trustee. Some of the estate is liquidated at once and the proceeds invested on behalf of the beneficiaries The trustees will obviously not ignore such investment opportunities as the security affiliate will provide. There are commissions to be earned both ways and the funds will remain in the bank. Furthermore, the beneficiaries will establish accounts, if they do not already have them, into which the income will be paid. To a certain extent this income is paid from other accounts belonging to corporations who are paying interest on bonds or dividends on stock. Again the risk of exposing the bank credit to alien atmosphere is reduced.

A Source of Additional Business

The part of the estate which remains unliquidated may consist of office buildings, apartments,

farm land or other forms of real property. As the various payments are made to the bank as trustee innumerable opportunities are presented for the solicitation of accounts. Furthermore, this administration of real property opens another vista for the integrated bank. All of this property requires insurance. Why take any part of the income and subject it to the risk of departure from the affectionate embracing arms of the bank? The latter goes into the business of underwriting insurance. The premiums are now paid by a transfer of credit from one account to another in the same bank. The same kind of opportunity is presented when the bank accepts bills of exchange either directly or through an acceptance affiliate. The goods while in warehouse and in transit must be insured. *Voila* the bank is at the merchant's service. Nor is the merchant whom the bank is accommodating likely to debate the merits of this insurance.

Integration and Size as a Stabilizing Influence

All these functions which in the integration of banking have been acquired are additional roots with which the great trunk and branch system supports itself. The more numerous these roots and the deeper they sink the more stable the business of the bank. One form of service leads naturally into another and the greatest hazard of banking,

the simultaneous demand for payment by a substantial number of clients, is reduced. This, the protection of the bank's accounts, is probably the strongest motive for integration. There are others of which two will here be noted.

Killing the Bond Salesman

The bank possesses an invincible advantage over the specialized institution in the sale of related financial services such as insurance and securities. Distribution costs are the bane of the latter business. The insurance salesman and the bond salesman absorb the lion's share of the costs of distribution. The bank by virtue of its confidential and influential position at the portal of the client's account can dispense with both. One is led to wonder whether the days of these professions are not numbered. The Canadians have already become fully alive to this danger.

Canadian Bond Dealers Protest

When the Select Standing Committee on Banking and Commerce of the Canadian House of Commons undertook the revision of the Dominion's banking statutes a resolution by the Bond Dealers Association of British Columbia was addressed to it. This resolution complained of the encroachments of the great banks upon the business

of legitimate bond houses and alleged in substance that,

1. Engaging in bond business is an abuse of the powers of the banks.

2. It was an unfair encroachment upon the business of private firms.

3. That the banks have organized special bond departments, have installed stock exchange wires, issue printed lists of bonds for sale and advertise for public support.

4. Since banks have knowledge of their clients' business and are custodians of public funds they are liable to misuse their power.

5. With their country-wide branches and business affiliations they offer unfair competition to the established bond business of the country.[13]

Canadian Insurance Agents Protest

The insurance agents of the Dominion joined the bond salesmen in protest. There was some evidence that the banks abused their powers in the solicitation of insurance. The Canadian banks are prohibited by law from engaging directly in the sale of insurance. This provision of the law is as effective as that in our own code which prevents national banks from selling stock. The Canadian banks by means of subsidiary trust companies con-

[13] *Proceedings of the Select Standing Committee on Banking and Commerce of the House of Commons*, Canada, on Bill No. 83, An Act Respecting Banks and Banking, 1923, p. 514

trolled the insurance of their clients. When a customer applied for a loan he was advised that it could be arranged provided his insurance were placed with the right trust company. We may take the example of the Merchant's Bank of Canada and the Bankers Trust Company which had identical boards of directors. The Montreal Shirt and Overall Company as a condition for certain accommodation was "instructed" to place $300,000 of insurance with the Bankers Trust Company. It was also testified that the manager of the Victoria branch of the Merchant's Bank refused the extension of credit to a large concern unless certain insurance paying a premium of $15,000 was given to the Bankers Trust.[14]

So aroused were the agents of the Canadian Federation of Insurance Agents by the threat to their existence that they joined in a vehement protest known as "The Montreal Declaration." It was indorsed by all the insurance companies in the Dominion, with insignificant exceptions, and presented to Parliament.[15]

Abuses Admitted and Defended

Although the representatives of the great banks tried to refute these accusations they admitted enough to give the charges of coercion some color.

[14] *Ibid*, p. 623

[15] *Ibid*, p. 619.

Mr. R. P. Jellett of the Royal Trust Company, an affiliate of the Bank of Montreal, testified,[16]

"We have a power which is very commonly exerted by people who have money to lend, and that sort of thing, to make certain stipulations, and if we made a stipulation that during the time we are lending money to a certain person he shall insure through an agent selected by us, that I conceive to be a proper exercise of the power of a person lending money—" Which apparently lets pussy out of the bag.

The opportunity to eliminate distribution costs, sound economically, has its seamy side. Whether our banks will have the good judgment to avoid the abuses which have crept into Canadian banking integration remains to be seen.

Direct Earnings of New Functions

The most obvious advantage in the sale of services related to the banking function consists of the direct earnings. The financing of foreign trade, the sale of securities, insurance and fiduciary services all contribute to the income of the large bank and relieve it of sole dependence upon the chief bank functions of investing and lending. This is well illustrated by Ratio No. 11, "Interest and Discount Received to Gross Earnings." In 1921 the banks in our first group received a little more

[16] *Ibid.*, p. 669.

than 88 per cent. of their total income from interest and discount. By 1929 this had declined to less than 80 per cent. The banks in our third group,

INTEREST AND DISCOUNT RECEIVED TO GROSS EARNINGS

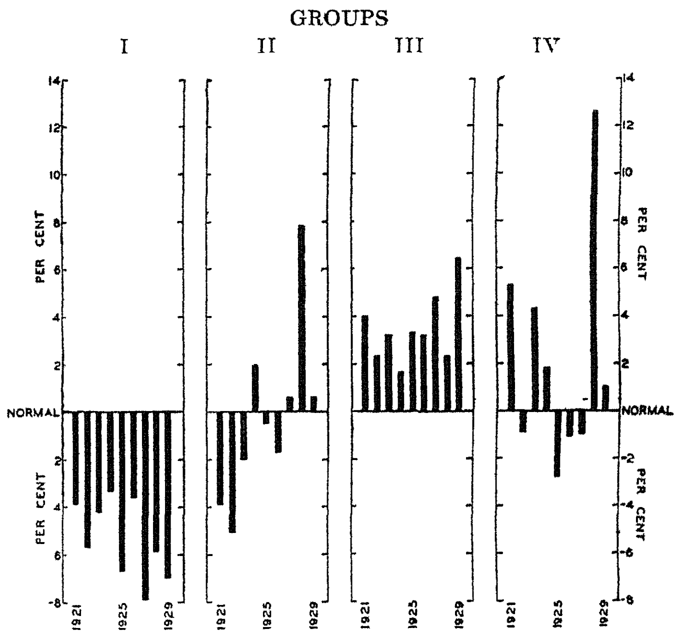

CHART XI

The normal line is the average of all national banks in the United States Percentage is of gross earnings Basic data are taken from the annual reports of the Comptroller of the Currency

consisting of small country banks, still received more than 93 per cent. of their gross earnings from loans and investments.

Dividends the Final Test

The final test of large scale banking to the stockholder is the return which he receives on his investment. The abstract profits of banking, be they ever so impressive to the student and promoter, can become articulate only through dividends. We shall now undertake a comparison of the profits of Canadian banking, English banking and the four groups of American banks. The comparison with Canadian banks is rather sketchy because of the inadequacy of Canadian statistics. Sir Edmund Walker, president of the Canadian Bank of Commerce, testified that the return to stockholders on their investment ranged from 6 to 6½ per cent. during the period 1913 to 1922.[17] A comparison has been made on a weighted percentage basis of dividends to paid-up capital and surplus of the Canadian banks and our national banks from 1890 to 1920.

RATIO OF DIVIDENDS TO CAPITAL AND SURPLUS OF CANADIAN BANKS AND AMERICAN NATIONAL BANKS[18]

Year	Chartered Banks	National Banks
1890	5.65%	6 10%
1895	5.18	5 00
1900	5.01	5.60
1905	4.76	6.10
1910	5.10	6.70
1915	5.20	6.30
1920	5.90	6.70

[17] *Ibid.*, p 577

[18] Willis and Beckhart, *Foreign Banking System, op cit*, p 464.

The following table presents the ratio of net profits to capital and surplus of the "Big Five" chartered banks of England and our own groups of Big Banks, Medium Banks, Small Banks and Small Banks in Distress Areas for the years 1927, 1928, 1929. The figures cover calendar years for the "Big Five" and fiscal years for the American banks.

NET PROFITS TO CAPITAL AND SURPLUS OF ENGLISH AND AMERICAN BANKS (per cent.)

	1927	1928	1929
"Big Five" English chartered banks [19]	10 05	10 09	10 21
American Banks [20]			
Big Banks	11 58	8 88	10 05
Medium Banks	10 40	9 70	10.60
Small Banks	8 52	8 73	9 06
Small Banks in Distress Areas	3 38	5 65	7.83
Country Banks of			
Maine	14 42	13.05	12 41
New Hampshire	10 02	10 36	10.44
City Banks of			
Birmingham	13 36	12 47	15.64
Dallas	11.94	10.78	14.95
Louisville	14 91	10.06	14 66
Cincinnati	13 27	11.82	11.78
Denver	10.74	13.19	12 85
Seattle	14 69	22.15	13.63

Special Advantage of English Banks

The "Big Five" achieved their earnings with the aid of more than 8,600 branches and a ratio

[19] Based upon data in *Commerce Reports*, March 17, 1930, pp. 697, 698

[20] Based upon data in *Reports of the Comptroller.*

of deposits to capital and surplus of 14 to 1. The ratio of deposits to capital and surplus of our group of big American banks is 4.5 to 1, of the country banks of Maine and New Hampshire 7.66 to 1 and of the city banks of Birmingham, Dallas, Louisville, Cincinnati, Denver and Seattle 6.63 to 1. This appears to load the dice very heavily in favor of the English banks. Let us subject the profit figures to another test to determine the relative earning efficiency of the banks. How much does each group realize in net profits per dollar of capital, surplus and deposits, taking the aggregate of the latter items?

RATIO OF NET PROFITS TO AGGREGATE CAPITAL, SURPLUS AND DEPOSITS, 1929

"Big Five"	.68 per cent.
Big American banks	1 83 per cent.
Country banks of Maine and New Hampshire	1.32 per cent.
Medmium size banks of six American cities	1 83 per cent.

The English banks represent the final flower of the concentration process. The putative manifold advantages of large scale banking should find in the English system their most convincing concrete expression. So far as profits and earning efficiency go, there are still great areas in America where the unit bank need not bow its head.

An examination of the ratio of net profits to capital and surplus (See Ratio No. 12) for this country reveals the fact that the returns which are

NET ADDITION TO PROFITS TO CAPITAL AND SURPLUS

GROUPS

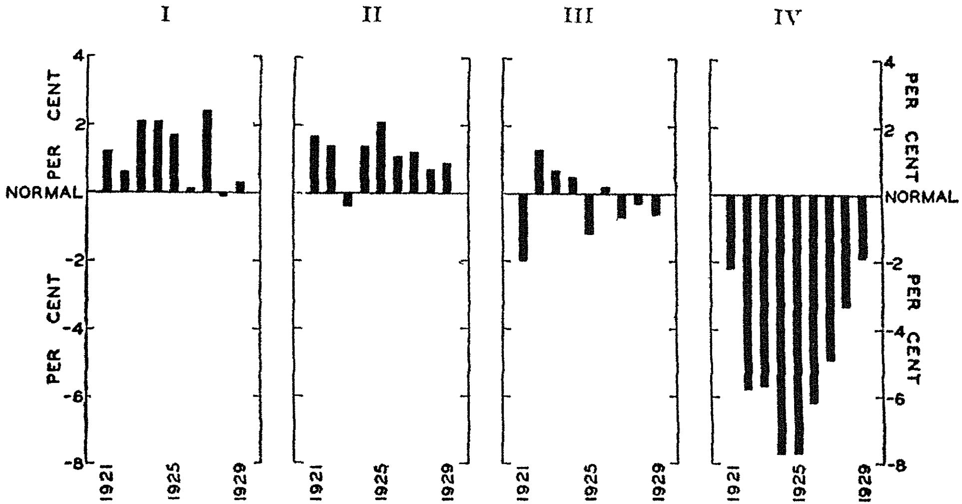

CHART XII

The normal line is the average of all national banks in the United States Percentage is of gross earnings. Basic data are taken from the annual report of the Comptroller of the Currency.

most heavily weighted for branch systems, extending beyond the immediate community in which the parent bank operates, hardly flatter the earning

JOINT STOCK BANKS IN ENGLAND AND WALES[21]
NET PROFIT AS A PERCENTAGE OF TOTAL WORKING RESOURCES

Year	Number of banks	Percentage (Weighted Average)
1874	63	1.88
1883	90	1.67
1891	95	1.13
1896	124	1.13
1901	63	1 21
1906	—	1 07
1911	37	96
1913	37	1.13
1914	32	94
1915	32	86
1916	30	82
1917	29	73
1918	20	.71
1919	16	69
1920	15	79
1921	15	63
1922	15	.58
1923	14	.57

capacity of branch banking. The testimony coming from San Francisco is dominated by the Bank of Italy National Trust and Savings Association which has 292 branches. The capital and surplus of this bank accounts for 76 per cent. of the aggre-

[21] This is based upon figures compiled by J. Dick, *Journal, Institute of Bankers*, London, April, 1897: figures prepared by Sir D Drummond Fraser. *Ibid*, 1907, and calculations of Joseph Sykes based upon data in London *Economist* See *Amalgamation in English Banking, op cit*, p 129.

gate capital and surplus of the six banks which reported to the Comptroller from this city on June 30, 1929. The returns from San Francisco are therefore largely the returns of this single institution. This earning's experience shows returns to the stockholder far below those which accrue to the average bank stockholders in the United States. Substantial as are the economies which branch banking may effect economic disabilities are encountered which more than offset them. This conclusion is supported by English experience. It reveals a declining ratio of net profits to total working resources over a period of 50 years.

Extenuating Factors

In extenuation of the poor showing of the English and California banks it may be urged that the great branch systems under consideration are still in process of expansion and that many items properly chargeable to capital account have in fact been charged against earnings. It takes from three to six years for a new branch to justify itself and while a system is still actively growing it may well be that the energy consumed impairs profits for which compensation will appear in that future when stability is achieved. As against this it has been urged that the branch organization, especially in England, has had ample time to overcome the drains of adolescence, that unsatisfactory earning

efficiency is due to the extravagant wastes of branch organization. The economies and wastes of branch organizations we shall consider in the next chapter.

Investment Realism

With these arguments the investor will have little patience. He is—or at least should be—a realist. According to the *bulk* of the evidence he should not look to bank concentration and bank expansion through the establishment of elaborate branch systems for an increase in dividends. Large scale banking under competent management may result in more stable if reduced earnings. Concentrated capital possesses tremendous power. Its related lines of influence bring a flow of business which relieves the bank of a harrowing dependence upon fortuitous general or local conditions. It is in a position to modify those conditions. Instead of being the tail of business it is now the head. The great bank is unctuous balm to the pride of the leaders. It gratifies their instinctive lust for power. Does the stockholder share these sentiments?

CHAPTER VIII

The Economies and Costs of Concentration

The economic motives of concentration must spring from the prospect of improving existing sources of profit, adding new sources and eliminating or reducing costs. Where combination takes place among banks which are already great by every measure, it is due, aside from the human factors, to the possession of complementary qualities in the merging institutions. Its purpose is to achieve a more perfect balance in integration.

A Recent Merger as an Example

This is well illustrated by the merger of the Chase National Bank and the Equitable Trust Company of New York. The Chase National Bank has a powerful and presumably profitable security affiliate. It does an enormous straight banking business and, with its own foreign branches, foreign correspondent affiliations and control of the American Express Company,[1] reaches for business to all parts of the commercial globe. With this great emphasis upon banking, security distribution and foreign trade financing, the growth of its trust

[1] The American Express Company at the end of March, 1930, had sixty-six foreign offices

business had lagged behind. The Equitable Trust, on the other hand, had always been more of a trust company than a bank. It was possible, therefore, for these two banks to effect a marriage which would carry the promise of more perfect integration. In view of the fact that the wide-spread adoption of the uniform trust makes trust administration on a large scale entirely feasible, the aforementioned union appears attractive.

The Uniform Trust

A word is necessary about the uniform trust. The administration of an estate has always been considered a matter commanding personal attention. It is a form of service which is not susceptible to mass methods. As a trust official of a great English bank, who had been sent to America to study the trust methods of our largest banks, expressed the problem, "It is possible for one man to take care of ten trusts and even a hundred trusts, but when they mount to a thousand and then approach ten thousand the man does not live who can keep his fingers on all of them and do a good job." So the Midland Bank sent an envoy to America to study our methods!

Investing for an Estate

The most responsible part of trust administration is the investment of the funds of a liquidated estate. It is a task which requires exceptional

training, a high order of intelligence and a selective judgment well tempered with caution. It is not an easy matter to find men who possess these qualifications. Our trust companies have met the situation by developing a common trust fund in which each estate holds a definite number of units. The income is apportioned among the beneficiaries according to the number of trust units which each one holds. Provision is made for liquidation and withdrawal, usually on thirty days' notice. The vicarious participants in the trust fund share in its appreciation.

Illustration

To illustrate the procedure let us assume that a bank has one hundred estates, each of which upon liquidation yields $10,000 for the administration of which the bank is appointed trustee. Instead of establishing a separate investment schedule for each account, they are lumped together and the $1,000,000 is invested in a list of stocks and bonds selected by the trust committee of the bank. The equity of each beneficiary amounts to 1 per cent. of this fund. There is a proportionate distribution of the income and a proportionate participation in any changes which take place in the value of the joint investment account. The trust officers of the bank, instead of dissipating their investment attention over a hundred accounts, can now con-

centrate on what is virtually a single account. They meet once a week for review of the security portfolio and make what changes their judgment dictates. In effect this arrangement constitutes an investment trust administered by the bank's officers on behalf of the beneficiaries of its trust funds.[2]

The Trust and Security Business

It requires but little perception to see how attractive a vast trust business can be to a bank which has an active security affiliate. The latter can always find in the trust committee a willing purchaser of more or less substantial blocks of the issues it is distributing, the amount taken depending entirely upon the size of the trust business. We have here a complete and self-propelling chain of business.

Another View

While this self-sufficiency is attractive to the stockholder and the promoter, it is possible to view it in another light. The uniform trust carries much the same appeal to the trust beneficiary as the investment trust does to the investor in common stocks, *i. e.*, the assurance of proper diversification and adequate supervision. One cannot help but wonder to what extent the committee in charge of

[2] For a description of the uniform trust see "Operation of the Uniform Trust." *American Bankers Association Journal*, March, 1930, p 841.

the trust investment portfolio will suffer its vision to be clouded and its judgment to be warped by the desire to "help along" the security affiliate of the bank. Unless we deny to self interest its prime position as the motivating force of human conduct, we must assume that the aforesaid vision and judgment, be it ever so impressive in the abstract, will be influenced by the necessities of the affiliated security company.

Importance of Integrity and Independence

The soundness of the uniform trust idea is then made to depend upon the judgment of those officers who underwrite the issues in the distribution of which the security company participates. Nor have the banks without the benefit of security associations neglected to call attention to this weakness in that team play which constitutes the higher integration of bank functions. Here is the Central Hanover Bank and Trust featuring as a lead for its full page ad the caption, "No Securities For Sale," followed by the statement, "Whenever we are called upon to invest money for our clients, we are free to choose securities from the whole investment field. Only with this freedom, we believe, can we choose the securities that best suit the needs of each individual client." [3] The point is not without force.

[3] *Ibid* February, 1930, p 754

Operating Ratios

Turn now to the statistical verdict and consider first the operating ratio of our big banks as compared to the other three groups. Here we find that the big banks not only have the lowest operat-

NET EXPENSES TO GROSS EARNINGS

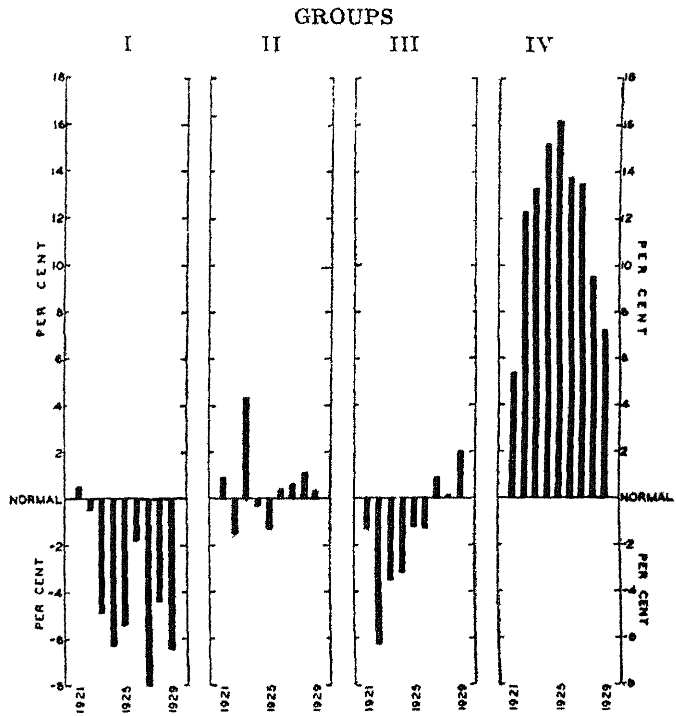

CHART XIII

The normal line is the average of all national banks in the United States. Percentage is of gross earnings. Basic data are taken from the annual reports of the Comptroller of the Currency

ing ratio for all the groups but have registered the greatest improvement during the period 1921-1929. In 1921 the banks in this first group *as a whole* paid out $82.50 in expenses for every $100 which they received in earnings. In 1929 this had dropped to $72.40. The clear margin of net profit had risen from $17.50 per $100 of earnings to $27.60. The net profit per $100 of earnings for the medium banks is $17.10 in 1921 and $20.90 in 1929. The small banks in the third and fourth groups show some fluctuations, but on the whole remain stationary. Marked exceptions to the group averages may be discovered in each group. Generalizations therefore may be made only with an emphatic caution to that effect. The record of our California banks taken alone and without the aid of the excellent New York scores is not as good as that of the medium sized banks in the second group or the small country banks in the third group. The New York banks show an amazing record. For the three years 1927-1929 they are able to set aside as clear profit approximately $3 out of every $10 of gross earnings.

Interest on Deposits

The item "Interest on Deposits" bulks large in all bank expenses. The banks in Group I appear to advantage but it must not be concluded from this that they pay lower rates to their depositors

INTEREST ON DEPOSITS TO GROSS EARNINGS

GROUPS

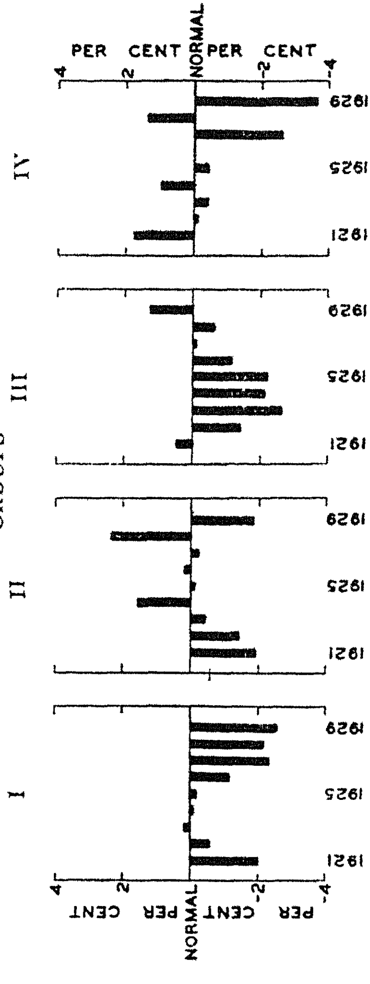

CHART XIV

The normal line is the average of all national banks in the United States. Percentage is of gross earnings. Basic data are taken from the annual reports of the Comptroller of the Currency

or allow interest on fewer accounts. The Ratio No. 14 is a comparison of interest paid on deposits to gross earnings. The latter item, as we have seen,

is compounded, in the case of the large banks (see Ratio No. 10), of greater earnings from extra banking functions. It is a singular fact that the item shows an increase of approximately one-third for all the banks except those in the last group, the country banks in distress areas.

Interest Received Compared to Interest Paid Out

A much better picture of the part played by the interest paid to depositors is supplied by the ratio of the interest so paid to the interest and discount received by the bank. This excludes the influence of the extra banking functions. (See Ratio No. 15) Here we find a marked uniformity in the four groups as a whole although there are great differences within each group. The California banks pay out much more of their interest receipts to their own depositors than do the banks in New York City. The three national banks in Cleveland are paying out about one-half of their interest and discount received in the form of interest on deposits and the same is true of the country banks of Maine. The country banks of New Hampshire, in sharp contrast, pay about half as much to their depositors as do the banks in the neighboring state. Down in Texas only about one-fifth of the interest received by the bank is paid out to the depositors. In fact it may be said of our fourth group, the country banks in distress areas, that as a whole

INTEREST PAID ON DEPOSITS TO INTEREST AND DISCOUNT RECEIVED GROUPS

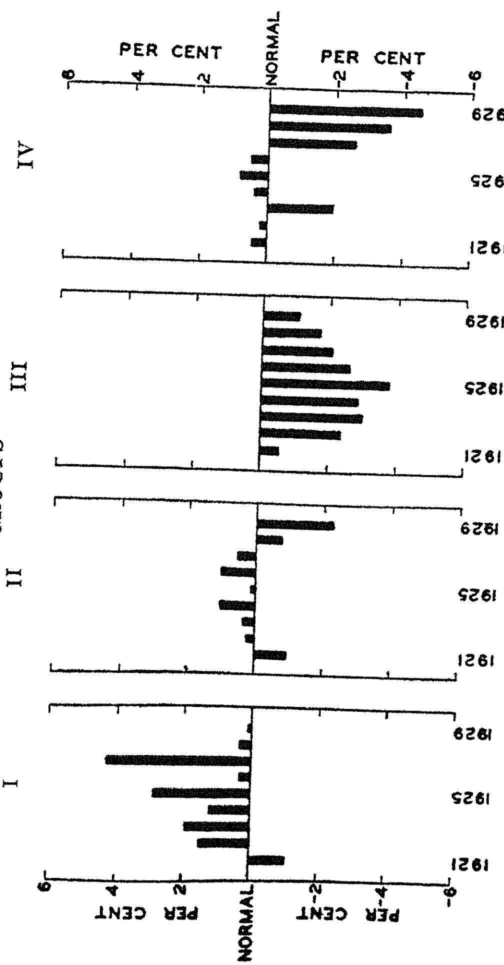

CHART XV

The normal line is the average of all national banks in the United States. Percentage is of gross earnings. Basic data are taken from the annual reports of the Comptroller of the Currency.

they pay less of their interest and discount received back to their customers than do the banks in the other three groups.

Salaries

One of the difficulties of the small bank with inadequate capital and uncertain business was the necessity of paying its chief executive officer a salary that comported with the dignity and responsibility of the position rather than with the amount of business done. This cut rather heavily into the slender margins of earnings and we see ample evidence of this in the ratio of salaries and wages to gross expenses (see Ratio No. 16) for our small banks in distress areas. The 93 national banks of South Dakota set aside 29 per cent. of their gross earnings for this purpose as compared to 13 per cent. for Maine, 14 9 per cent. for Pittsburgh and 17.1 per cent. for New York City. However, the record for the California banks on this score is not so good. It is to be noticed that the percentage for San Francisco jumps as soon as the returns for the Bank of Italy branch system are included in 1928. Although the great banks of New York are able to realize some economies in salaries and wages, it is clear that they are not shared by the far-flung branch systems of California. There has been an increase all along the line in the proportion of gross earnings allotted to the bank worker.

Taxes

For no apparent reason the banks in the first group have an outstanding advantage in the rela-

SALARIES AND WAGES TO GROSS EARNINGS
GROUPS

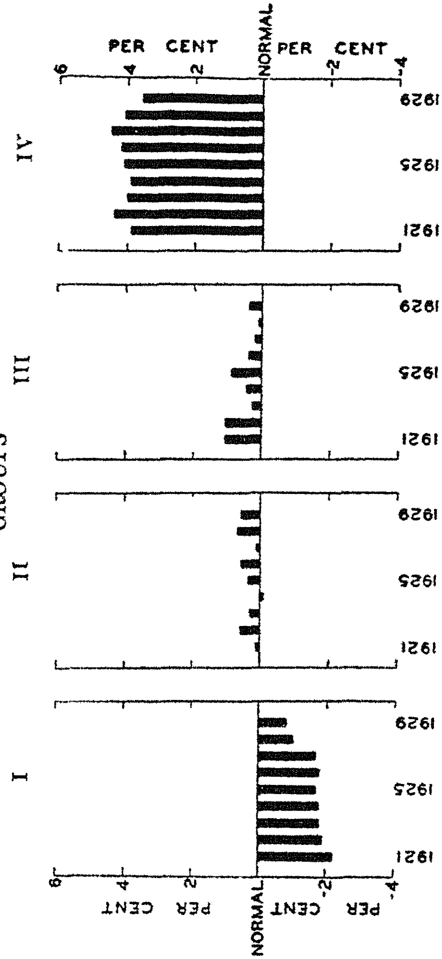

CHART XVI

The normal line is the average of all national banks in the United States Percentage is of gross earnings Basic data are taken from the annual reports of the Comptroller of the Currency

tive burden of taxes. These banks have cut down the proportionate parts of their gross earnings set aside for taxes by more than 50 per cent. during

TAXES TO GROSS EARNINGS GROUPS

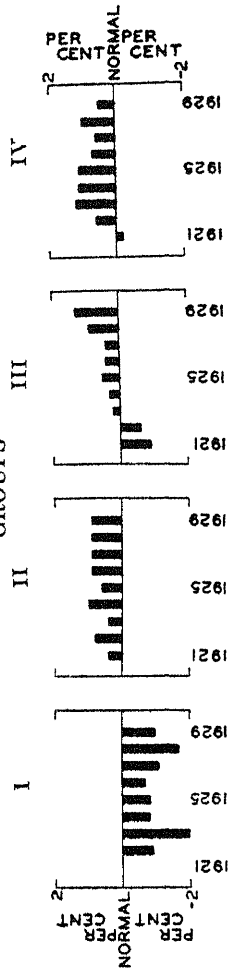

CHART XVII

The normal line is the average of all national banks in the United States Percentage is of gross earnings. Basic data are taken from the annual reports of the Comptroller of the Currency

the last nine years and the economy applies to the banks in all three of the cities. In 1921 they were compelled to set aside $7.30 out of every $100

earned while by 1929 this had been cut down to $3.60. This contrasts with $5.50 paid out by the banks in the second group, $5.90 by the banks in the third group and $5.10 by the banks in the last group. We have here an entirely unsuspected economy in overhead in favor of the great bank. It is probably due not to any discrimination in favor of the larger institution but rather to the greater aggregate of gross earnings in relation to the taxable base.

Large Scale Banking Record Dominated by New York Returns

In spite of some of the very impressive economies of large scale banking which our statistical study has revealed, it must be borne in mind that the greater portion of these are attributable to the excellent record of the great banks of New York City. The expansion of banking in an agricultural community or in a region that shows less intense commercial concentration may provide a verdict of an entirely different nature. There is a suggestion of this in the returns from San Francisco. For additional evidence on this subject we must turn to England and Canada.

English Experience

English banks have enjoyed the limelight of international attention for many years. Amalga-

mations, extending over a long period of years, had raised these institutions to a position where their supremacy remained unchallenged until the course of American concentration forced one and then another American bank into the rank of the charmed five and finally above them. The anticipated economies of large scale banking are not sustained by English experience. Consider the following table of expenses as a percentage of total working resources presented by Sykes.[4]

JOINT STOCK BANKS IN ENGLAND AND WALES
EXPENSES AS A PERCENTAGE OF TOTAL WORKING RESOURCES AND NET PROFITS

Year	Number of banks	Percentage of total working resources	Percentage of net profits
1881	54	.86	52
1886	54	.88	60
1891	51	89	60
1896	41	89	77
1901	30	95	82
1906	23	1 08	89
1910	20	1 09	101
1911	20	1.08	103
1912	9	1 03	94
1913	7	1.06	89
1914	8	1.02	97
1915	5	1 04	111

Results of English Studies

In his conclusion that bank expansion has resulted in increased expenses, Sykes found himself

[4] Sykes, Joseph, *Amalgamation Movement in English Banking*, p 150.

in agreement with two other students who had examined the movement in its earlier phases. His analysis of expenses was compelled to proceed largely by inference and a process of elimination due to the lack of data. In two cases, those of the Union Bank of London and the London and Westminster Bank, he was able to trace the course of expenses and correlate them with growth.[5] For the Union Bank expenses showed a slight increase during the period 1879 to 1901 due to increase in staff salaries and directors' remuneration. In 1902 it absorbed six private institutions and in 1903 four other banks, three of which were of substantial size. Proportionate expense immediately mounted more than 20 per cent. and remained there until the outbreak of the war.

The London and Westminster Bank starts in 1880 with eight branches and shows expenses for the first few years which amount to a little less than one-third of 1 per cent. of gross working resources. As its branch structure grew so did the relative proportion of expenses. In 1908, with thirty-seven branches, its expenses amounted to a little less than one-half of 1 per cent. of gross working resources. In 1909 this bank combined with the London and County Bank. The proportionate expenses of the two banks increased to 1.08 per cent. of gross work-

[5] *Ibid.*, pp 137-139

ing resources and by 1913 had reached 1.26 per cent.

Passing the Added Cost to the Depositors

So severely did the growth of expenses press upon profits that the banks passed the consequences of amalgamation back upon the depositors in the form of reduced rates upon deposits. Until 1921 the rate on deposits had always been 1½ per cent. below the bank rate. In that year the banks increased the margin to 2 per cent With the Bank of England rate as it is today at 3½ per cent., that means a return to the depositor of 1½ per cent. One wonders how the American depositor, accustomed to rates ranging from 2 per cent. on very active accounts up to 4½ per cent. on inactive accounts, would react to such an effect of concentration.

Passing More of It to the Borrowers

In spite of the relief afforded by this step the pressure of expenses upon earnings continued so severe that another remedy, embraced at the expense of bank clients, was taken in 1924. Until that time the banks had been in the custom of accommodating the money market at a rate varying from one-quarter to one-half of 1 per cent. above the deposit rate. In that year the rate was raised so that now a uniform differential of 1 per cent.

prevails between the deposit rate and that paid for money market funds. It is also necessary to consider the extremely favorable ratio of deposits to capital of the English banks in order to form a fair picture of the efficacy of large scale banking.

Giganticism and Red Tape

There is increasing reference to the unwieldiness of the English system, armies of clerks confined to monotonous tasks in highly specialized departments, management straining under the effort to secure some semblance of efficient teamwork among the various departments, no one of which seems to know what the others are doing, elaborate hierarchies of inspectors and supervisors, endless reports and regulations, an appalling amount of red tape, banking impersonalized apparently to the last degree.

The Other Side of the Shield

The following passage taken from the *Journal of the Institute of Bankers* is typical of the Englishman's reaction to the banking Titans with whom he must carry on a relationship that is essentially intimate and personal. "We hear on all hands tales of lack of proper collaboration between departments, of queues of minor officials waiting outside the doors of the more highly placed, and unable to obtain the decisions necessary to efficient admin-

istration, of misunderstandings and delays which a banker of an earlier generation would regard with the utmost dismay. The banks are, in fact, face to face with those difficulties inherent in institutions above a certain size. . . . Any of the largest banks has got to such a size that no single individual, whatever his powers for work, can at the same time direct its policy and control the working of its administrative detail. . . ." [6]

The Personnel Problem

The personnel problem of the great English bank is a serious matter.[7] Not only has the management lost vital contact with its clientele but also with its employes. The latter have become so many dehumanized cogs in a great machine even as the former has become the inorganic raw material of a large scale business operating with mass production methods. We see great personnel departments devising mechanical methods for the classification of employes, seeking desperately for formulae which will automatically allot each human worker to his appropriate pigeon-hole, promotion by time service, personal merit weighed by cold objective instruments, the atrophy of personal ambition and the blight of vibrant interest in work. These are

[6] *Journal of Institute of Bankers*, May, 1920, p 155, quoted by Sykes, Joseph *The Present Position of English Joint Stock Banking*, p 114.

[7] *The Banker*, London, February, 1926, pp 188-189

the stigmata of bureaucracy. They are creeping over our own banks.

The English Branch Manager

A revealing light is cast upon the attitude of the branch manager toward his superior and its implications regarding his own freedom to serve the community in which he is located by the advice of an experienced branch manager to the neophytes. In laying down rules he places first the injunction "never to argue with his head-office officials. . . . It is wiser for the manager to put his tongue in his cheek and accept their ruling without a protest." [8]

A Pleasant Contrast

It is somewhat of a relief to turn from this chill picture to the moderate sized American bank where the bank president still knows the names of all the clerks and the two together still know all the clients. The subordinate worker in many cases owns a share or two of the bank's stock and works eagerly for the day when his energy and devotion will find recognition in promotion. That is a type of spiritual sunshine which has long since departed from the sombre counting rooms of the mammoth English banks. It is a factor whose absence or

[8] *Ibid.*, March, 1926, p 237

presence finds a definite reflection in the profit and loss statement.

Looking to Canada

It is to Canada that we must look for a more effective demonstration of what we may expect in this country if branch banking pursues its apparently inexorable course. Its presence and the hint of effects are clearly indicated in the increasing absorption of capital by the physical structure of the branch system.

CHARTERED BANKS OF CANADA

RATIO OF BANK PREMISES TO PAID-UP CAPITAL AND SURPLUS

Year	Ratio
1890	5 11%
1900	6.39
1910	13 72
1920	23 13
1928	28.52

The testimony of bank officers as well as the records indicate that the branches of the great banks are a severe strain on profits. Many little towns in the western part of Canada with a population not exceeding four thousand have from three to five banks. In the city of Edmonton in a single block there are eight enormous buildings, each one a bank. Any one of these would be adequate for the needs of the city. Although these banks charge 10 per cent. per annum compounded monthly for

accommodation they nevertheless fail to show a profit, according to the testimony of a high bank official.[9] The town of Weyburn in southern Saskatchewan, with a population of 3500, has six banks; High River in Alberta province, with a population of 1200, has five banks. The little frontier settlement of Grand Prairie in the same province has five branches of chartered banks.

[9] *Proceedings of the Select Standing Committee on Banking and Commerce of the House of Commons,* Canada, 1923, p 160.

CHAPTER IX

Branch Organization and Uniform Interest Rates

It is this phase of branch banking which has, perhaps, been subject to more extravagant glorification by its advocates than any other. The argument is specious, the appeal strong but spurious. Through a branch organization, so it is alleged, the surplus funds of the affluent sections of the country are piped to the impecunious areas and, the level in both being equalized, the interest rates charged are the same. The picture of the humble husbandman in a remote agricultural district securing accommodation on the same terms as the puissant merchant in the metropolis makes an attractive story but it is just a story.

Deferred Blessing in Canada

At the hearings before the Canadian Parliamentary Committee, to which reference has already been made, it was brought out that the rates charged in western Canada were considerably higher than those charged in the East. The bulk of the farm loans was made at 8 per cent. The Weyburn Security Bank, operating in Saskatche-

wan, usually charged 10 per cent. and the members of the Committee alleged that they knew of instances where the rate was 12 per cent.[1] Sir Edmund Walker conceded that the high rates charged to the farmers of the West were made necessary by the great cost of furnishing banking facilities.[2] Apparently there is no competition among the banks in interest charges. In the town of Grand Prairie in northwestern Alberta there are five branches of chartered banks. They all charge 10 per cent., which is discounted.[3]

High Rates in Western Canada

Rates in western Canada vary from 7 to 12 per cent. These extremes are exceptional and the more common range is between 8 and 10 per cent. This is higher than the borrower in the eastern provinces pays and, as in the United States, the disparity is a source of irritation to the western farmer as well as political ammunition for his representative. The latter sees in the discrimination the evil effects of monopoly or of a conspiracy among the banking interests to exploit the farmer, etc. To an American accustomed to the intemperate advocacy of the farmer by our own western representatives this all sounds very familiar.

[1] *Ibid.*, p. 941

[2] *Ibid.*, p. 520.

[3] *Ibid.*, p. 948.

Agreement to Maintain Interest Rates

Professor McGibbon, who made a special study of banking in the Province of Alberta,[4] thought that he detected signs of a vicious concert among the banks to maintain interest rates at a high level, particularly at Grand Prairie and Peace River Crossing. These two outposts, with a combined population of less than four thousand, had eight branches serving them. The rate at every branch was 10 per cent. He won an admission from one of the branch managers that the matter had been discussed informally among the banks in Winnipeg and concluded that the 10 per cent. rate was the result of deliberate agreement. Such a statement has political possibilities and they were fully exploited.[5]

Legal Prohibitions

The Bank Act has a perfectly innocuous provision concerning the rate of interest to be charged by a bank. A hasty reading might indicate that a bank could not charge more than 7 per cent. The prohibiting part of the clause reads ". . . but no higher rate of interest shall be recoverable by the bank." Since the banks are authorized to deduct the interest at the time the loan is made and since

[4] McGibbon, D A *Report of the Commissioner on Banking and Credit with Respect to the Industry of Agriculture in the Province of Alberta*, 1922.

[5] *See House of Commons Debates*, June 19, 1923, pp. 4105, 4125.

in fact that practice is generally followed, the prohibition is merely a futile legal gesture. The attempt to change this and make the rate of 7 per cent. effective failed in 1923.

Reasons for Disparity in Rates—Economic Immaturity

Among the reasons for the difference in rates between the west and east of Canada may be cited the following:

The western part of Canada is immature economically and, like all young communities, is avid in its need for capital. The new settlers who come there rarely have adequate means and for years thereafter the margin between production and consumption is entirely insufficient to meet local capital requirements. Every pioneer community tells the same story. Capital adequacy comes only as economic maturity is realized. Capital redundancy is the attribute only of old and well developed regions. Since it responds to changes in supply and demand, it must be expected that adolescent communities should pay a higher rate to attract a capital supply from markets where it is available.

An Unpalatable Explanation

The representative of western clients finds this fact unpalatable or incomprehensible. He has postulated a perfect liquidity of capital. If it fails to move from areas of plenty to areas of scarcity,

excepting only under the stimulus of a higher rate, he is certain that some artificial and sinister hand retards the process. This relative scarcity of capital in the western part of Canada is revealed more strikingly in the bank statements of the western branches of the great banks than in the similar statements of our own unit banks. The latter are invariably started with local capital which is often woefully inadequate in view of the responsibilities which the banks will assume. Such deposits as they have are largely the result of their own lending activities. It is only through borrowing from correspondents in the big cities that a movement of capital takes place to the needy centers.

Movement of Capital in U. S. Not as Clear as in Canada

Permanent capital is provided from the outside through the insurance and land mortgage companies and, since the establishment of the Federal Farm Land Banks and the Joint Stock Land Banks, through the sale of bonds. This manner of providing funds somewhat obscures the movement and we do not get as clear a picture as we do in the statements of the Canadian banks. In the latter we find the loans in the western branches invariably far in excess of the deposits. There are instances where loans are three times as great as deposits. No independent unit bank could operate on such a basis without enormous capital. In

Canada the accumulations of the East flow through the branches to the West. The propelling power is the higher interest rate of the West. As long as the prairie provinces require more capital than they can themselves provide they must procure it elsewhere and must recognize the higher price paid as the only means in the premises under which this can be accomplished.

Greater Risk

A second reason for the higher rates which prevailed in the West is the greater risk as reflected in the larger losses sustained in the western branches The greater percentage of losses is well established, not only in western Canada but in our own West. The higher charge, therefore, is justified, not only in accepted economic theory but also in established financial usage. This reason was stressed by Sir Edmund Walker.[6]

Greater Cost

The third reason is the greater cost of providing proper banking facilities for the small communities of the West. This is due partly to the fact that branches are established in small towns where the overhead, distributed over a small amount of business, is very heavy, and also to the excessive competition among the banks in the establishment of

[6] *Proceedings of the Select Standing Committee, op cit*, 1923, p 520

innumerable branches in the same community for no other reason than the desire to prevent a competitor from getting a foundation. These communities therefore pay a higher price for that splendid banking service and that zealous competition which has been rather extravagantly extolled.

Erroneous Impression of Canadian Capital Mobility

In spite of the well established and marked disparity of regional rates in Canada, the close mechanical connection between the various branches of the same system has led American students to believe that the Canadian system has definite virtues in the mobility of its funds as contrasted to the American system and that the Canadians on the outposts of the commercial area enjoy an access to capital not shared by the victims of the unit banking system across the border.

CHAPTER X

INTEREST RATES CHARGED TO FARMERS IN CANADA AND THE UNITED STATES

BEAR IN MIND that nominal rates in western Canada vary from 8 to 10 per cent. High as this may seem, it is probably lower than the rates which the American farmer must pay for his short time loans, particularly in the less attractive lending districts. If we glance at the rates charged by member banks on customers' paper rediscounted with the Federal Reserve banks,[1] we find that in the five districts where banking conditions may be said to resemble those in western Canada, rates vary from a low of 7.2 per cent. in the San Francisco district to a high of 9.8 per cent. in the Dallas district. The period covered is from 1921 to 1928 and the data come from banks in small towns and cities. On the surface there appears to be a striking similarity between the rates charged in the United States and those prevailing in Canada.

A Difference

There is a difference, however. The evidence relating to rates in Canada is direct. It comes

[1] *Annual Report of the Federal Reserve Board*, 1928, p. 102.

from the testimony of bank officials, borrowers and students such as Professor McGibbon. The evidence which we have used for the United States comes from borrowing banks through the medium of the Annual Report of the Federal Reserve Board. It applies only to those loans of customers which have in turn been rediscounted at Federal Reserve banks. The requirements of eligibility are such that we may be certain that only the best paper has been rediscounted. The rates appearing in this official document therefore relate only to the best kind of paper. The direct evidence which we have for this country indicates that our rates are slightly higher than in Canada.[2] Our western states show the same range of rates as the western Canadian provinces. They seem, however, to approach the upper limit of 10 per cent. more frequently than the lower limit of 8 per cent.

Rates Nominal

We have said that the rates quoted are nominal. They do not represent the actual cost of the loan to the borrower.

In the first place, he is usually expected to maintain a balance in his account which bears some substantial relation to his loan. In the United States the average of such required balance is probably in

[2] See *Bulletin* 409, U S Department of Agriculture, 1916, *Yearbook*, United States Department of Agriculture, 1924, p. 222.

the neighborhood of 20 per cent.[3] This is the average and the practice varies greatly. Patently the cost of a given accommodation then depends largely upon the size of the balance which must be carried in the bank. A 20 per cent. required balance makes a 6 per cent. loan actually cost 7½ per cent. while a 40 per cent. balance would boost the cost to 10 per cent. Under commissions and bonuses the banks again exploit an opportunity to get more than the nominal rate of interest. It was found in the State of Georgia that these charges added about 2 per cent. annually to the cost of short time credit.[4] The insistence upon frequent renewals has the effect of compounding the discount rate in addition to being a source of great irritation to the farmer whose productive period is longer than that contemplated in the normal commercial loan. There are many other devices by which the actual interest rate becomes more than meets the eye. As an example we may cite the case of the Kansas City Joint Stock Land Bank, which at times compelled its borrowers to subscribe a fixed percentage of the loan for the capital stock of the bank.

Frank Adjustment of Rates to Client in Canada

There is some reason to believe that the Canadian practice is a little more revealing than that

[3] See Chester A Philips, *Bank Credit*, The Macmillan Company, New York, 1921, p 42

[4] *Op cit.*, *Bulletin 409*, U S Department of Agriculture

in the United States. A representative of the Weyburn Security Bank, testifying before a Parliamentary committee, stated that the bank varied its rate according to the quality of the applicant's account, a strong borrower getting the low rate of 8 per cent., while the weakest borrowers paid the top of 10 per cent.[5] Slight as it is, it may be possible to relate this differential in favor of the Canadian farmer to the structure and methods of the Canadian banking system.

Mobility of Funds One of Many Factors

The first and most exaggerated reason is the mobility of funds within a banking system which embraces well settled and comparatively mature communities and others which are just learning to walk. The facility with which funds can be moved from the former to the latter is undoubtedly a factor in the provision of adequate credit on reasonable terms. It is a general experience among the great Canadian banks that loans exceed deposits in their western branches while just the reverse is true of the eastern banks. The maritime provinces with their surplus of capital and young pioneer provinces of the far West thus make an ideal Jack Sprat-and-his-wife combination.

[5] *Minutes of Proceedings*, etc., 1913, pp. 424-5.

Fallacy of "Idle" Funds Notion

However, this cannot be a complete or satisfactory answer. Much the same profit considerations actuate the concerted management of a series of banks as the detached management of a series of independent banks. That is to say, the management of a great bank with thousands of branches does not move funds from the seaboard to the interior because it cannot find any use for those funds in the areas in which they originated. It is a fallacy to speak of idle funds. If they are available they can be used—at a price. This price is necessarily the one which prevails in the community where it is proposed to employ the funds and if that happens to be a community of substantial capital accretions then the natural market rate for funds must be comparatively low. In transferring those funds from low interest paying markets to high interest paying markets, the bank management is simply selling the merchandise of the system in the best market. That can be accomplished even though the instruments of distribution, the banks, do not fall within the pale of unified management.

An Osmosic Process

In our own country the infiltration of funds into the agricultural regions of the West and South takes place through an economic osmosic process which cannot be explained as the direct transfer of

funds from the wealthy urbanized communities to the capital impoverished areas of the hinterland.

The Channels

There was first of all the direct borrowing of the small banks of the interior from their great correspondent banks of the cities. This movement did not take place without squeaks and groans. The friction of awkward and antiquated machinery took its toll of inconvenience, uncertainty and higher rates. Crude as it was it nevertheless did permit the movement of funds from market areas of plenty to those of relative scarcity. In addition to the commercial banks, we have a legion of private mortgage companies which act as the intermediaries between the farms of the interior which require capital and the lenders of the city who are seeking safe and profitable investment. Again, this is not the best system in the world and yet despite its crudities it functioned. Finally we have the great insurance companies whose investment departments were constantly scanning the country for opportunities to place profitably the accumulating surplus of the insurance business. They have accounted for a substantial and rather constant portion of the total of long term loans made to those rural regions which we are accustomed to view as lacking in capital. Through the commercial banks, the private land mortgage companies and the insurance

companies we find a seepage of capital from areas of redundance to areas of scarcity.

Improving the Process of Transmission

These inefficient channels of capital transmission were functioning in their crude way long before the Federal Reserve Act was passed. One of the purposes of that piece of legislation was the clearance of those channels to provide greater mobility of funds. It was intended that this should be accomplished in two ways, by the establishment of an open money market and by the right of member banks to rediscount eligible paper, which in turn could be passed by one Federal Reserve Bank to another in the event that a particular district felt too great a pressure for funds. Since we are here concerned not with a general fluidity of funds but rather with the movement of credit to those outlying sections which ordinarily experience great difficulty in securing adequate credit, it is necessary to appraise the value of the machinery established by the Federal Reserve Act in that particular connection.

Uniformity of Interest Charges Not Realized by Federal Reserve System

Did the Act make it any easier for the farmers of North Dakota, let us say, to tap the great capital reservoirs of the East? A categorical answer can-

not be provided for this question. In the first place the statutory aspirations for a free money market were doomed to temporary disappointment. The campaign of the Reserve authorities for a vigorous acceptance market proved abortive, although latterly and without any encouragement from these same authorities it has developed a surprising vigor. Be that as it may, we can point out here that the requirements for admission were such as to exclude completely those famished areas whose high interest charges have been the subject of unfavorable comparison with the corresponding Canadian areas. The same may be said of the rediscount privileges which the Act gave the farmer. True, his paper was allowed a period of six months which was later raised to nine months, but it is doubtful if this proved of material aid in leveling out inequalities in interest charges.

Central Bank Rates Have Little Effect Upon Rates Paid by Borrower

The great majority of the small banks serving the high interest paying areas were state banks without the system and could not avail themselves, except indirectly, of the apparent access to cheaper money. Furthermore, there is little reason for believing that membership in these cases would have had any effect on the rates which these banks charged to their own customers. Consider the rates

charged by banks in small towns and cities (under 15,000) on paper rediscounted with the Federal Reserve banks.

INTEREST RATES CHARGED BY MEMBER BANKS IN SMALL TOWNS AND CITIES ON REDISCOUNTED PAPER IN FIVE FEDERAL RESERVE DISTRICTS

	Atlanta	Minne-apolis	Kansas City	Dallas	San Francisco
1921					
December	7 9	8 7	8.9	9 7	8.2
1922					
December	7.9	9 0	8.8	9.8	8 0
1923					
March	8 0	9 0	9.0	9.7	8.1
June	7 8	9.0	8 7	9.6	8 2
September	7.8	8.6	8 6	9.4	8.1
December	7.7	8.9	8.6	9.7	8 0
1924					
March	7.7	8.8	8 7	9.4	7.9
June	7 8	8.8	8.9	9.6	7.9
September	7.6	8.7	9.0	9.4	8.2
December	7.7	8.6	8.6	9.8	8.0
1925					
March	7.7	8 8	8.9	9.5	8.0
June	7 7	8.6	9.0	9.4	8 0
September	7.4	8.3	8 6	9.3	7.1
December	7.5	8.2	8 3	8.3	7.6
1926					
March	7.8	8.6	8.5	9.6	7.8
June	7.8	8.7	8.7	9.3	7.8
September	7.7	7.8	8 6	8 6	7.8
December	7.7	8.2	8 1	9.1	7 6
1927					
March	7 8	8.4	8 3	10.0	7.7
June	7.8	8 7	8 6	9.6	7 8
September	7.6	8.1	8 7	8.9	7.5
December	7.9	8.3	8.4	8.9	7.2

Annual Report of Federal Reserve Board, 1927, p. 93

Heavy Differential Between East and West Persists

In these five districts only San Francisco may be said to reveal a declining trend. The rates on customers' paper for all the districts as a whole do show a tendency to decline but the evidence is least impressive in the very areas where one might expect the improved mobility of funds via the Federal Reserve System to have the greatest effect. The equalization of interest rates so fondly expected by the founders of the system has not materialized. The farmer in Wyoming must still pay a heavy differential as compared to the business man of New York or even the farmer of New York in securing accommodation from his bank. And the strange part of it all is that the bank which extends credit to the fruit grower of New York and the bank which discounts the paper of the Wyoming rancher both borrow funds from Federal Reserve banks which charge precisely the same rates. Mere transferability, therefore, through a banking system hardly accounts for the more favorable terms on which the western Canadian farmer can apparently borrow.

Special Privilege for Farmer

As a final comment on the inability of the Federal Reserve System and the vaunted facility with which it transfers funds to reduce the rates and improve the availability of credit to the American

farmer, is the fact that special and privileged means of securing credit have been provided for him. The Federal Land banks, the Joint Stock Land banks, the Federal Intermediate Credit banks, the War Finance Corporation and the Farm Board, with its revolving fund of a half billion dollars, all constitute efforts to provide the farmer with cheap credit and all of them were made after the passage of the Federal Reserve Act. The point we are striving to make is that the mobility of funds within the Canadian system, helpful as it may be, is not a cardinal factor in providing the Canadian farmer with credit on more favorable terms than those enjoyed by his American neighbor.

Reasons for Differential Between Canadian and U. S. West—Rigid Safety Rules

What can explain this differential? There are two reasons, the greater safety of loans made by the branch banks and the existence of competition. One of the most highly lauded virtues of our unit banking system is the free play of individual initiative which it permits the local banker. We have heard much about his understanding of local needs, his sympathy with local aspirations and his personal knowledge of all his clients. The local client's line of credit depended largely upon the banker's appraisal of him as a credit risk. It is significant of the flexibility and freedom of our unit banking

system that fully two-thirds of the loans made by our commercial banks to farmers are made on the basis of personal security.[6] This was largely a subjective process devoid generally of such formal factors as net worth, ratio of quick assets to quick liabilities and various other balance sheet refinements which are the props of the branch bank manager. Such a banker could make loans to clients who could not qualify as borrowers at a branch bank. The excessive number of banks in our western states laboring under the straitened necessity of earning a return from limited business, combined with the freedom of the local banker from all formal restrictions, led to the granting of loan applications which the branch manager could not consider. It was a case where local conditions and the exigencies of limited business often forced the commitments of the independent banker beyond the bounds of safety. The greater risk of poorer loans was compensated for in part by higher charges. The loans made to Canadian farmers by the western branches of the banks bear a lower rate of interest than those made to American farmers across the border by the unit bankers for precisely the same reason that the loan to the New York farmer bore a lower rate. They were better loans. They were safer loans.

[6] *Yearbook of the Department of Agriculture,* 1924, p. 223.

Character Loans and Restriction of Choice

Granted equal safety, however, there is still another reason for the higher rate paid by the American farmer. In Canada the relationship between the farmer and his banker is a purely business relationship. In America, particularly in the small towns, it is largely a personal relationship. In Canada, Jones can get a loan not because he is Jones but because his position and his tangible and ascertainable prospects of repayment warrant the loan. In America, the independent banker is by no means blind to these factors but he is more likely to view Jones in a personal light. "Character," due entirely to the intimacy of the banker and his little community, receives an unconscious and imponderable emphasis. Sometimes Jones gets his loan largely because he is Jones. The vitality of that factor in banking judgment enables Jones to get a loan where a detached examination of his qualifications as a borrower might result in a denial.

Unit Banking and Monopoly

On the other hand, Jones would have considerable difficulty in getting a loan elsewhere. His banking account, such as it is, has always been maintained in the same bank and if he cannot get a loan there he is up against it. It is not like buying a pair of shoes. If local stores appear to charge too much, he can go to the next town and

make his purchases. Such freedom of choice for banking accommodation is not open to the ordinary applicant for credit in the typical small American town. The local banker, in fact, enjoys some of the attributes of monopoly power. He can charge Jones 10 per cent. and if Jones considers the rate exorbitant there is little he can do except try to get along without it. Unfortunately, he can rarely do that.

Importance of Credit and Limitation of Opportunity Under Two Systems

The failure of the application may halt an entire train of productive efforts even as the failure of a match may prevent a heap of fuel from yielding its warmth and energy. Furthermore, the attempt of Jones to secure accommodation elsewhere will hardly endear him to the local banker. Jones knows very well that he need never come back to the old bank. This is not the case when Jones buys shoes. It is not the case when he borrows from a branch bank in Canada. In the latter, there is cordiality, certainly, but the applicant is regarded impersonally. The merits which he has as an applicant will open the door for him at one branch as well as at another. The branch managers work under similar rules and the position which establishes eligibility at one will in all likelihood establish it at all the others. With a number of branches operating in

the same town we have the semblance of a capital market and competition among the sellers of a particular service. The borrower has a real choice.

Personal Bond Has the Faults of Its Virtue

This is not the case in the small American town. The personal bond between the banker and the client prevents alternative solicitations for credit and by the same token gives the banker the opportunity to charge a higher rate. Paradoxical as it may seem, competition among the great Canadian banks seems to have prevented precisely that type of credit monopoly which the American contemplates with such abhorrence. The unit banker, on the other hand, has found it possible to establish a type of petty local monopoly in some instances as vicious in its incidence on a small scale as anything which ever disturbed the reflections of our ardent legislative champions of freedom.

Character of Canadian Competition Favors Eligible Borrower

Our conclusion, then, on the subject of interest charges under branch and unit banking is that the Canadian borrower does enjoy a slight differential and that the able local borrower derives a benefit from a type of competition which we do not yet have in this country. On the other hand, it is probable that many applicants on this side of the border

secure aid who could not qualify under the Canadian system. Our local bankers do not discriminate among borrowers as do the branches of the Weyburn Security Bank, for example, where the able borrowers pay 8 per cent. and the poor risks pay 10 per cent. In our western communities the former support the latter. The result is a higher average rate. The spirit of enterprise finds a greater tolerance under unit banking and we pay the price in terms of heavier losses and higher rates. Is the price too great?

CHAPTER XI

The Branch Manager and Community Growth

No automatic formula has yet been evolved by which an applicant for a bank loan can be placed upon a scale and his integrity and ability weighed to determine the safety of the loan. The appraisal must still be personal. It is this character scrutiny which constitutes the final test of the banker's skill and judgment. Can a salaried employe with impermanent tenure and no proprietary interest in the business effectively discharge this responsibility? We can answer this only by a resort to experience.

California Experience

The laws of California have been very tolerant of branch banking and we find in that state the largest branch system in the country, embracing at the time of writing the parent bank and 292 branches. To what extent are the managers of these branches able and free to exercise that vital personal judgment which is the distinguishing mark of the true banker?

City Branches

As far as the branches in the city of the parent bank are concerned, we may say that they are merely physically detached counters of the main bank. They are manned by from three to seven clerks who have practically no initiative or discretion whatsoever. All applications for loans are passed on to the main office and accommodations granted to applicants only in strict accordance with instructions. Where an independent bank within the city has been acquired and converted into a branch there is some exception to the above statement and greater latitude in lending is permitted. However, most of the branch growth in the cities has taken place through the establishment of new offices and these are merely physical outposts of the main bank in which all the vital banking functions remain centralized. Unless the applicant secures a direct contact with the source of discretion his personal qualifications as a borrower have been excluded from the evidence which finally determines the fate of his application, excepting only insofar as the branch manager succeeds in transmitting an impression on to Olympus. The branch office then is a more or less deadening insulation of that personal core upon which the independent banker relies.[1]

[1] An excellent account of the facts appears in Southworth, A. D., *Branch Banking in the United States*, pp. 99-109.

Country Branches

The conduct of the country branches differs materially from that of the city branches. This is due first to the fact that practically all the branches have at some time in the recent past been independent banks. In their acquisition by the parent bank the original officers have been retained. The president of the former independent bank has become a vice-president of the greater bank and remains the chief executive officer of the branch. In fact some of the branch systems of California have more vice-presidents than a Latin-American army has generals. It is a gentle and euphemistic compromise with the old system. Within limits, the old officers retain the discretion and freedom of judgment which they possessed before they became members of the greater family. The fiction of independence is thus maintained although the death warrant of the fact has already been signed.

The Transition from Independent to Branch Banking

The retention of identity has been facilitated by the physical difficulty of exercising the same measure of detailed supervision over distant country branches as is possible with branches within the corporate limits of the city in which the parent bank is located. Unfortunately, vice-presidents, even vice-presidents of California banks, are not immortal. They do not partake in any sense of

the eternal life of the corporate entity of which they have become executive officers. When they pass on, as indeed some have already done, branch managers take their place. The threads of control are grasped a bit more firmly by the central office. In the course of time we may see a branch structure in California very much like that in Canada and England today. Already we hear complaints of the sterile formalism of California branch banking.[2]

Branch Managers in Canada

Due to the greater maturity of branch banking in Canada we find the appointment of branch managers made on a different basis than in California. Presidents of small unit banks in Canada are an extinct race. The great banks therefore turn to employes, invariably men who have had from five to ten years' training as accountants. They are first given some experience as relief managers in the districts to which they are eventually appointed. Once appointed, they appear to have considerable discretion in the granting of loans. In small towns the range is from $1000 to $15,000 and in the larger cities of such provinces as Manitoba and Alberta the limit reaches as high as $75,000.[3] The practice varies among the different chartered banks but it

[2] Whaley-Eaton Questionnaire *Branch Banking*, p. 34.

[3] *Proceedings of Select Standing Committee*, 1923. *op. cit.*, pp 392-393.

seems quite clear that the Canadian branch manager enjoys a greater measure of discretion than is true of city branch managers in California or branch managers of any type in England.

Velocity of Circulation of Branch Managers

The complaints of the Canadian seem to be directed chiefly to the brief and uncertain tenure of the branch manager. Evidence introduced at the hearings conducted by the Select Standing Committee of the Canadian Parliament in 1923 indicated that the average tenure of a branch manager was about two and a half years.[4] There have been special reasons for the velocity of turnover of branch managers.

Reasons—Effects of War and Rapid Expansion

The rapid expansion of Canadian banks during and after the war led to the equally rapid promotion of new managers and consequently to an excessive turnover. It was not always possible to train a new manager properly before granting him an assignment. When we add to inexperience the alloy of incompetence which rapid selection cannot avoid and the kaleidoscopic shifting of positions it can readily be seen that branch bank management was properly the subject of severe criticism.

[4] *Ibid*, p 632.

Particular Difficulty in Banking

The difficulty in banking is far greater than it would be in any other industry. The relationship between the banker and his client is close and personal. It is impossible for the manager to set up an infallible formula for credit accommodation. Accounting methods in rural communities are such that the insistence upon statements would bar many meritorious applicants from the bar of credit. We have already alluded to the fact that approximately two-thirds of the advances made by private bankers in our own country to farmers have been made on the basis of personal security. To the credit of Canadian banking intelligence and its adaptation to a serious impediment of large scale banking it may be said that it has fully realized the vitality and importance of the personal factor in banking It serves to explain the amazing latitude granted to branch managers.

The Tie Between the Manager and the Client

It is in view of the importance of the personal judgment which the manager forms of the client that the frequency of change assumes such serious proportions. This judgment must be based to a certain extent upon continuous observations. The longer the manager knows the client the less liable to error will his appraisal be. A branch manager who has conducted a bank for three or four years

has accumulated a series of impressions of the bank's customers based upon constant observations and contact which are invaluable in the determination of individual credit problems. This acquired fund of impressions cannot be passed on to a successor who comes from without the community. It is utterly wasted when a change takes place.

The Client Takes Punishment

On the other hand the client suffers also. He has discussed his problems with the manager and acted upon his advice. He has come to look upon the man behind the manager's desk as his friend. When suddenly a strange face greets him the personal bond between himself and the bank has been severed and the process of spinning must commence all over again.

An Injustice to the Client

Sometimes the situation is more serious. The client has discussed his program with the manager and secured the promise of assistance. With that assurance he makes his own commitments and preparations. When he is ready to use the aid promised he discovers a new manager who has been instructed to "clean up" the district. This man has no sympathy with the plans of the client and no intention of abiding by the promises of his predecessor. Such an experience embitters the

applicant and undermines that happy relationship between banker and client which is so essential to the effective discharge of the banking function.

Three Causes

The excessive turnover of branch bank managers has been due to three causes. Two of these have been beyond the control of the banks while the third is a phase of bank policy which can be modified.

War Casualties and New Branches

The war naturally took its toll of branch managers as it did elsewhere and it was necessary to fill the gaps. In the second place there was an abnormal expansion of bank branches during the early post-war years and it was necessary to find managers for the new branches. These changes involved a certain amount of shifting throughout the system. These are obviously temporary causes and will take care of themselves in the course of time.

Rotation for Experience

Of a different nature, however, were the changes which the banks effected for the purpose of providing training for their officers. On the whole their temporary appointment in one place only to be shifted shortly to another is hardly

the best type of experience. It may serve to establish with such an official certain formal and fast rules which he will set up in self defence as he is moved rapidly from one place to another. The experience is costly to the official himself, to the communities which he must serve in turn and finally to the bank which employs him. The banks, it should be said, are seeing the error of their ways and are abandoning this practice altogether or are providing experience in subordinate capacities.

English Branch Managers

English branch bank manager experience has been much the same as in Canada. The post-war period brought an excessive turnover of managers and served to accentuate the centralization of discretionary power in the home office. The English banks apparently have not gone as far as the Canadian banks in granting autonomy to their managers. The English manager in consequence is much more the "elderly clerk" type than is true of his Canadian counterpart. Apparently all applications for loans are first transmitted to the central office accompanied by the statement of the borrower. With it goes the recommendation of the branch manager and his judgment of the applicant's character, all submitted on proper forms. In cases where the applicant happens to be a

powerful and well known client the procedure is expedited and the local manager may call the central office by phone and secure an immediate decision. Customary borrowers are also granted a definite line of credit by the home office within which the manager is free to make advances without previous consultation with his superiors. This line of credit is checked periodically and the changed condition of the borrower taken into account in altering or confirming it.

Circulating Apprenticeship Being Abandoned

The necessity for having local men in charge of local banks has been perceived by the great English banks. The practice of training officials through a circulating apprenticeship as branch manager of a number of different branches has been rather generally abandoned. A vacancy usually results in a scouring of the community for suitable local timber. The banks seem to feel that an able local man even though he know nothing of the technical phases of banking is preferable to a carefully trained stranger. If the man has other requisite qualifications for the position the acquisition of technical knowledge should be a simple matter.

We see then that the importance of the personal factor is being increasingly recognized by

our great branch systems. They are making intelligent efforts to supply that particular element of effective banking which the unit banker has always been in a peculiarly advantageous position to provide.

Branch Banking and Economic Development

In view of the position and limitations of the branch manager, what effect does his displacement of the unit banker have upon the economic development of the community? The American student of banking has been so appalled by the impressive list of bank failures in this country during the post-war period and so elated by the apparent immunity of the Canadian banks that he has postulated a perfection for the latter which we have questioned and are questioning. With the thin gauze of superficial excellence he has combined certain abstract advantages such as unified control, mobility of funds, superior management, and diversified risks to spin an illusion of faultless virtue.[5]

Creditable Role of Canadian Banks

Certainly the part played by the great banks in the development of Canada has been highly

[5] For an idealistic description of the branch system as it operates in Canada see Foster F. Meredith, "Canada's Experience With Branch Banking," *American Bankers Association Journal*, February and March, 1930 Also Willis and Beckhart, *Foreign Banking Systems*, pp. 447-450

creditable and the author has no desire to subtract one whit from their splendid record of service. However much branch banking may seem to check the spirit of enterprise, Canada has forged ahead in spite of that. It is also possible that branch banking as administered in Canada has succeeded in avoiding the discouragement of individual initiative which seems elsewhere to have been the necessary consequence of branch banking. Nor does the economic growth of Canada sustain the fear that branch banking is contrary to the genius of a free people. The evidence clearly credits the Canadian banks with keeping abreast of the outposts of the Canadian frontier and providing banking facilities for communities long before they could have enjoyed the same measure of service from unit banks.

Branch Banking and Pioneer Development

Large scale banking as practiced in the Dominion displayed itself to advantage during this phase of Canadian development. A vast banking organization can subsidize its branches during their infancy. It can divert sustenance from its well established and profitable branches to the support of the new branches during that period when they are striking their roots. Although the desperate competitive race among the great

chartered banks to be the first in new fields led to branch excesses which were later passed on to the community in the form of higher interest rates, the latter in spite of that were no higher and probably not as high as the rates which similar American communities had to pay. Furthermore, the facilities provided the Canadian frontier communities were sound and safe. They have been free from the wildcat and extravagant speculative character of our own early pioneer banking. The irresponsibility of our primitive banks and their frequent insolvencies have necessarily been a grievous strain upon communities already suffering from capital impoverishment Such losses served to aggravate the void of capital.

Joint Responsibility of Canadian Banks

While the post-war period of Canadian banking has on the whole registered as great a mortality as our own banks the duty of amalgamation enforced by the Canadian Bankers Association as well as by the Minister of Finance placed the brunt of the losses in every case but one on the stockholders rather than on the depositors. This has been a great help to the far-flung rural areas of the Canadian West. The joint responsibility of the Canadian banks has in effect carried the banks through a prolonged period of depression with a minimum of inconvenience to depositors.

The banks have not only protected the assets of depositors but have maintained that confidence in the system as a whole which is the vital atmosphere of banking and prosperity.

Appraisal of Role Difficult

Great as has been the service of the Canadian banking system and free as we are to concede the tribute, there is nevertheless no warrant for asserting that Canada, economically, has attained her present enviable level because of the peculiar nature of the banking structure or that she would have been any less prosperous if she had matured with a unit banking system.

It is rather idle to attempt to measure the beneficial or harmful effects of a given banking organization upon the economic development of a country by any objective standards. Statements of income, of wealth, of population growth, of years of prosperity compared to years of depression, of increases in foreign trade, in freight car loading, pig iron production, department store sales, and bank clearings cannot be taken as criteria of economic progress for purposes of comparison with some other country like our own which has not the highly developed branch banking system of Canada.

Results Show Only That Economic Progress and Branch Banking Are Not Incompatible

These yardsticks of progress are significant only in so far as they are yardsticks of progress. They fail utterly to prove that branch banking in the case of Canada has made that progress possible. In a negative fashion they show that exceptional economic well being is entirely compatible with branch banking. If we try to demonstrate that the two are causally related we must press our demonstration to its logical conclusion. The growth and well being of Canada compares very favorably with our own. In fact if we take some of the criteria to which we have alluded, *i. e.*, bank clearings, rate of population growth, and the number of years of prosperity in each business cycle, it is possible to "prove" that Canada has fared better than the United States. In fact one writer who regards the opponents of branch banking as "diehards," as visionary and tenacious adherents of a fallen cause, adduces the following evidence to confound these myopic advocates utterly. He quotes from a certain statistical study of the business cycle the fact that Canada has enjoyed 1.86 years of prosperity for every year of depression, whereas the miserable United States has had but 1.79 years of prosperity for every

year of depression.[6] In itself this is an extremely precarious foundation upon which to rest the conclusion of superior economic good fortune. To leap from this uncertain conclusion to another equally uncertain conclusion and aver that the hypothetical difference in well being is the result of a difference in bank structure is hardly warranted by the facts.

Canadian System Weakens in 1929

We do not wish to shatter wantonly these agreeable and painstakingly invoked images but there is a point or two on the other side which deserves attention. In view of the exaggerated exaltation of the Canadian banking system it might be well to indicate that the chartered banks permitted their gold reserves to shrink to such a low point in the desire to realize the greatest economy that the strain of the stock boom of 1929 virtually precipitated Canada off the gold standard. The fact was not acknowledged with any fanfaronade or crash of cymbals but for a number of months Canadian exchange remained far below the gold export point. It normally takes but 3/16ths of a cent to ship a dollar's worth of gold from Montreal or Toronto to New York and on large shipments that cost can be improved. One-

[6] Mitchell, W C, *Business Cycles*, National Bureau of Economic Research, p 410

quarter of a cent usually shows ample profit for a gold shipment from Canada to the United States. Yet between the spring of 1929 and the late fall the premium on the American dollar was often in excess of 1 per cent. and at times reached 2 per cent. It is somewhat disturbing to find this banking system operating on a margin so slender that the interruption in the flow of American investments into Canada caused by the stock boom should catapult the country off the gold standard.

Branch System Fails to Provide Salvation in Other Countries

Inasmuch as the branch system in Canada demonstrated its talismanic virtues by providing that country with .07 years of prosperity more per year of depression than the unit banking system was able to assure the United States, why did it not have similarly beneficial effects in other countries where it was as firmly established as in Canada? Here is England still in the slough of a post-war depression. What has happened to the formula of salvation? We have already referred to the Japanese debacle in industry and finance in 1927. It occurred in spite of the advanced stage to which branch banking had attained in that country. This analysis is obviously not profound but if we are going to make an inventory of the

garden let us count the weeds as well as the flowers.

Both Systems Have Served Well

It is entirely possible that if historical accidents had been reversed in the two countries so that the United States would now have branch banking and Canada unit banking the objective evidences of well being would be precisely the same. The banking system is but the handmaiden of the productive and distributive agents in the community. Productive power, the standard of living, the margin of savings, and consequently the rate of capital accumulation are dependent upon profound factors. Within *reasonable variations of bank structure* they are not substantially affected by the particular system of banking under which they flourish. Such a system of banking may retard or stimulate these factors, but only within narrow limits. We doubt that such effects can ever be amenable to statistical measurement. Both branch and unit banking have served their respective communities well. Whether the United States would have done better with branch banking than she has with unit banking is a problem of philosophic hypothetics.

CHAPTER XII

Bank Concentration and Monopoly

Three banks of New York City, the Chase National, the National City, and the Guaranty Trust, are now respectively the first, second, and fifth banks in the world in point of size. Former-governor Young of the Federal Reserve Board has estimated that one-half the banking resources of the nation are now in chain and branch systems. England has its "Big Five," Italy its "Big Three," France its "Big Four." Canada has eleven banks, but four of these eleven control four-fifths of the banking resources of the Dominion. Are we likewise about to witness the emergence of four or five colossal institutions which will dominate the banking landscape even as it is dominated by the great banks in other countries? Are we destined to see the recrudescence of that age-old fear of monopoly which has nowhere possessed the virility it has in this country? Is there a reasonable basis for this fear?

Fear of Monopoly

Monopoly is a word of sinister connotations. The fear of monopoly, like an ugly shadow, casts an umbrageous pall upon American history. The

early colonists who came to this country left an England in which political favorites secured compensation in the form of monopoly rights. A poverty stricken public was ground mercilessly to yield the substance of dissipation. Economic doctrine combined with these manifestations of favoritism to aggravate the burden. Mercantilism postulated the interference of the state in all forms of enterprise. Production and distribution were guided to yield maximum profits and to enable the state to realize greater power.

State Guidance of Production

The colonists were told what to buy, where to buy, and the complementary obligations of selling. It was the duty of the early settlers to purchase all finished goods from English merchants and to sell raw materials to English producers. Monopoly was the economic corollary of despotism and the colonist dreaded the former more than the latter. It mattered not that his fears were often ill-founded. They served nevertheless to establish that profound complex of apprehensions which we may call the anti-monopoly phobia of the American people.

Credit Restraint

Nowhere did monopoly appear to operate with greater viciousness, according to our untutored

forebears, than in the matter of credit. Pioneer communities are invariably communities destitute of capital and burdened with debt. They sought desperately for relief from this impecunious state. The colonial legislatures were more than complaisant. Bills of credit were issued to enable debt-burdened constituents to postpone the day of reckoning. The ultimate effect of note issue, operating through higher prices and a declining value of the unit of payment, was to evaporate the burden of debt. This very attractive procedure the home government sought to discourage for reasons which were incomprehensible to the humble debtor. He could see in the efforts of the distant state certain malign influences which his political representatives have been seeing ever since. The forces that were raising the price of tea and powder were working in maleficent concert with those which provided credit. There is ample reason to believe that the resentment of the colonies against the note-issuing restrictions of England was a major cause of that war which finally permitted the successful rebels to provide their own currency.

State Banks Come to Rescue

The situation was scarcely improved by independence. Our leaders, with an understanding of the reason for Parliamentary restrictions not shared by their followers, imposed the very

restraints from which the soldiers of the revolution thought they were emancipating themselves. Capital scarcity continued in the hinterland. The succor provided by the state banks was eagerly embraced. In the profuse note issues of these banks the debtor found relief from a harrowing bond.

First U. S. Bank as an Instrument of Monopoly

When the first United States Bank was chartered the currency excesses of the state banks were subdued—to the great annoyance of their clients. The insistence of the First Bank upon redemption was very embarrassing at times. This great bank appeared like a skeleton at a feast to put a stop to the humanitarian efforts of our small banks. Certainly the relief of a debtor is a "humanitarian effort." The most palatable explanation of the perversity of the United States Bank was its monopolistic character. Only such an influence could explain its draining of those wells of human charity in the interior so eager to allay the distress of an harassed class. When the First Bank sought a renewal of its charter, our legislators turned thumbs down. The country banks resumed their beneficent labors and again proceeded to supply impoverished communities with "capital."

Difficult to Appreciate Feeling of Early Settler Toward Banks

In spite of the fact that we have many legislators who would have found the backwoods banking intelligence of a century ago entirely sound, it is difficult for most of us to grasp the virulent animus which the early farmer cherished toward a great banking enterprise. Even so well informed a thinker as Jefferson gave way to outbursts that would do credit to Senator Heflin.[1] The story of the First Bank was repeated in the Second. Jackson, for reasons that were not clear to himself, cherished an invincible suspicion of the institution. He tolerated it only under pressure. Biddle was inept enough to provide him with an open *casus belli* and the president made himself the champion of all those elements which resented and feared concentrated money power.

Elaborate Precautions to Protect Public Against Monopoly

In the chartering of the banks every precaution was taken to protect the public against monopoly. Many states inserted elaborate provisions in the bank charters providing that initial subscription be opened in different parts of the state and limiting the number of shares which could be taken by one person. Congress, in chartering the First Bank of

[1] See *National Monetary Commission,* Vol. IV, pp 67, 68, 70-71.

the United States, required that subscription books should not be opened for more than three months (March 20, 1791, to July 1, 1791) to permit citizens in different parts of the country to prepare to subscribe and thus lessen the danger of concentration.[2] For three months after July 4 no one could subscribe for more than thirty shares on any one day. The provision for regressive voting was also inserted as a protection against monopoly. Thus twenty stockholders, each owning but one share, would have as great a voice in the selection of directors as one shareholder with a hundred shares. The rotation of directors was an added precaution quite generally adopted. The prohibition of interlocking directorates was common to all state charters.[3]

Keeping Funds at Home

The requirement that directors be local residents in the community served by the bank was again a protection against absentee ownership and monopoly. It was not the result of a desire to have bank directors with a better understanding of community needs. That is a comparatively modern refinement. These primitive borrowers were interested less in being understood than in securing adequate funds. The struggle for funds was not so much between various economic classes as between

[2] Dewey, Davis R., *State Banking Before the Civil War*, pp 22-23

[3] *Ibid.*, p 123.

communities. Today banking monopoly will result in the devotion of credit to favored industries or the stock market at the expense of the farmer. A hundred years ago it was the fear of interior communities that all credit would be used for the favored cities on the coast. We see a modern echo of this in the fulminations of John Skelton Williams who advised the world during and after our post-war depression that it was the result of the monstrous absorption of all credit by our great New York banks[4] In England we find a similar reaction to the control of the great banks. There is complaint that the branches sweep all capital accumulations out of the country districts and send them to London to the detriment of the communities in which these savings find their origin.[5]

Legislative Restrictions on Departure of Funds

The forebears of the present American client took positive measures to prevent such drains. Many of the states called for a limitation of bank loans not only to individuals but also to districts. The Bank of Kentucky, for example, could not lend more than two-fifths of its capital in Louisville. The balance had to be distributed among the branches. The Bank of Tennessee was required to publish a statement showing the amount to which

[4] *Congressional Record,* Dec 20, 1920, pp 563, 565

[5] Sykes, Joseph, *The Present Position of English Joint Stock Banking,* pp 76-77.

each district was entitled.[6] When the provision against lending more than 10 per cent. of capital and surplus to any one borrower was included in the National Bank Act, it was placed there as much to prevent the benefits of banking to accrue to any one person as to safeguard the bank against excessive concentration of risk.

National Bank Act the Triumph of Individualism

The National Bank Act itself is very definitely the triumph of individualism and a severe blow to concentration. The power to issue currency is taken out of private hands and placed virtually in those of the state. Branch banking is prohibited. This prohibition in large part is due to the association of certain banking abuses whose cause it was reputed to have been. Currency disorders and inadequate and sometimes wholly phantom capital were evils whose apparent matrix was branch banking. The correction of these ills therefore called for the extirpation of multiple banking. The intent was strengthened by the feeling that branch organization permitted concentrated money power. There is much reason to believe that if this prohibition had not been in the statute, banking in this country would have followed the course pursued in other lands and provided us today with a limited number of giant banking institutions.

[6] *State Banking Before the Civil War, op cit*, pp 191-192.

Banker as the Deliberate Agent of Distress

The denial of branches, however, did not lay the spectre of monopoly. The distress of the post-Civil-War period brought its crop of radical movements. Each one paid appropriate homage to the moneyed powers. The gesture is extremely ingenuous. Economic distress may be defined as that state where one does not have enough money to pay his bills and buy the necessities of life. In a strictly practical sense it consists of a lack of money. Now if some have more money than they can use and others have not enough to keep the wolf from the door then the world is topsy turvy and something ought to be done about it. The first task is to locate the villain. He should be human if possible and susceptible to the judicial processes of indictment and punishment. The banker is eminently eligible. He is the source of funds. If distress exists then he is the malign source. He is the trustee of community wealth and if suffering there be then he is clearly to blame. This may not be correct but it has the supreme virtue of being clear to tabloid mentalities. It is truly surprising how often the truth can be made comprehensible by alteration. We find in the populist and greenback party platforms reverberant denunciations of banking monopolies and the puerility of their economics is such that their inclusion is entirely in character.

The "Crime of '73"

The bimetallic controversy is well within the memory of living men. Its turbulent course was marked by villification of the banking fraternity and vitriolic abuse of the moneyed conspirators. When the monetary laws of the land were codified in 1873 the admission of silver to the mint was barred. The ratio of the two metals, gold and silver, had discriminated against silver so long and the white metal had sought the open market in preference to the mint for so many years that it seemed an act of obvious law economy to omit mention of silver. When the market ratio shortly thereafter turned against silver it sought refuge in the mint only to find the doors closed. The chagrin of the silver advocates joining forces with the distressed farmers turned upon the bankers in bitter abuse. The incident became the "crime of '73" and the villainous malefactors resided somewhere in Gotham.

Altering the Truth to Make It Clear

The position of the defenders of American liberty was taken by Mr. Coin. Coin's school issued a number of pamphlets which had a tremendous circulation.[8] Although they constituted an egregious misrepresentation of the case they had the

[8] See Coin, *On Money Trusts and Imperialism,* 1901 and Harvey, W H, *Patriots of America,* 1895

supreme popular virtue of being clear and colorful. They portrayed credit and money as the *sine qua non* of modern life. It was possible for man to get along without bread. He could do without water. But money and credit? Modern civilization found them indispensable and if man would live he must use them.

Source of Legislative Knowledge

Having established the vital necessity of a medium of exchange, the inspired Mr. Coin demonstrated its absolute control by a small group of wealthy, selfish, and entirely conscienceless conspirators. Mr. Coin has passed on, but a little attention to some of our Senate debates will reveal his continuing influence. It will disclose the source of some of our legislative knowledge of banking.

Appointing Thieves as Watchmen

Mr. Coin made much of the fact that the Secretary of the Treasury and the Comptroller of the Currency were both bankers. That seemed like placing thieves in charge of the family jewels. To appoint bankers to handle banking problems seemed not only the extremity of impropriety but the last word in wanton folly. Our present Congress is chafing under the consciousness that in one case, that of the Secretary of the Treasury, it has made the same blunder. Such error has not crept

into the appointment of the Federal Reserve Board. It is generously balanced for non-banking elements and one member at least must be a "dirt farmer."

The Pujo Committee

The labors of the Pujo Committee [9] were almost entirely the result of fears that a measure of actual concentration existed, not apparent on the surface, which was inimical to the public weal. The political sleuths of the national legislature spent many months at their arduous task until the hideous truth stood forth fully revealed. It was the ancient tale of the mountain that labored.

Federal Reserve Act

Then came the Federal Reserve Act. Here Congress found itself torn between desire and fear. It recognized the antiquated monetary and credit mechanism of the land. It was willing to clear away the deadwood of legislative impedimenta and create a new structure attuned to the needs of another age. On the other hand it seemed like handing the national patrimony of independence on a platter to a single group. That decentralization and local autonomy in banking matters wherein the nation had found safety against the encroach-

[9] *"Money Trust" Investigation,* Subcommittee, House Banking and Currency Committee, 1912-13

ments of monopoly was about to cease. Final vital judgment would henceforth repose in a small body of men in Washington. To deliberately create what they had desperately sought to prevent was too much. An illusion of decentralization was created. We now have twelve Federal Reserve banks instead of one, although power is concentrated in one place even as it would have been with but a single bank. The twelve banks are mute and otherwise futile tribute to the power of fear.

Chasing Spooks

Came the war and depression. The farmer suffered. The farmer's representative suffered. The old spectre was dragged forth. His attire was changed to suit new styles. The elixir of political buncombe was poured into his imponderable vitals and he rattled his bones as of yore. The populace trembled. A commission of investigation was appointed. It was known as the Joint Commission of Agricultural Inquiry. It produced a crop consisting of three volumes of hearings and four volumes of verdicts.[10] With some left-handed and rather mild criticism of the credit policy of the Federal Reserve Board the commission reluctantly concluded that there was no credit conspiracy or undue credit constraint, that Wall Street and business did

[10] Hearings, *Joint Commission of Agricultural Inquiry*, 3 Vols. Report, *Joint Commission of Agricultural Inquiry*, 4 parts Government Printing Office, Washington, D. C, 1921

not get an undue portion of the nation's credit and that the farmer on the whole was treated with considerate liberality. The ghost was—well—just a ghost.

A Slight Basis for Fear—The Gould Corner on Gold

This spectral political ally has been trotted out so often and over so long a period of time that one is impelled to ask "Does he possess any substance or is he a simon pure hallucination?" American history provides at least one instance of a corner in the foundation of credit which proved disastrous. Mr. Jay Gould, discovering some leisure moments from the arduous task of ruining the Erie Railroad, conceived the idea of setting a trap for exporters by cornering the supply of gold. The exporter usually sold his gold short in order to protect himself against any fluctuations in its price. When he finally secured a negotiable bill against his exports he sold it and with the proceeds made good his contract to deliver gold. The technique of the hedging process is such that he was automatically safeguarded against ordinary fluctuations in the price of gold. Mr. Gould, with the aid of a clique of brokers, speculators and Tammany politicians, and a bribe to an influential relative of President Grant who was counted upon to keep the Treasurer out of the market, secured a corner on gold. The twenty-fourth of September, 1869, was the fateful

day. About 250 individuals and firms were caught in the net of the conspirators and fleeced. The consequences were described by a Committee of Congress:

"Hundreds of firms engaged in legitimate business were wholly ruined or seriously crippled. Importers of foreign goods were for many days at the mercy of the gamblers and suffered heavy losses. For many weeks the business of the whole country was paralyzed, a vast volume of currency was drawn from the great channels of industry and held in the grasp of the conspirators. The foundations of business morality were rudely shaken, and the numerous defalcations that shortly followed are clearly traceable to the mad spirit engendered by speculation." [11]

Such a crisis need not occur every day to give the hue and cry of the demagogue the tone of plausibility.

The City of Toledo, 1889

Another instance of similar import which was extravagantly exploited at the time was the attempt of the City of Toledo, in 1889, to sell bonds with the proceeds of which it intended to install its own natural gas mains. The Standard Oil Company had intended to undertake this task but in-

[11] Quoted by Horace White, *Money and Banking*, 2nd edition, pp 152-153.

sisted on rates so utterly predatory that the city revolted. Toledo had been properly authorized to sell $750,000 of bonds to effect its release from bondage. So great was the power of the oil company that it succeeded in undermining the credit of the city and causing the issue to fail. The city, by resort to various heroic expedients, finally succeeded in completing its pipe line but the experience was a disagreeable object lesson of sinister and rather stupid monopoly.

Democratic Government and Public Protection

We must conclude then that the fear of monopoly in the past at least had some justification. It is a singular fact, however, that at the very time when the restraining hand of governmental power was most needed to protect the public it was most impotent. The eighties and nineties of the last century were the golden age of industrial piracy. Looking at the great captains of industry who held sway at that time and in word and deed emphatically damned the public, one can well raise the old Greek question, "What is the difference between a successful merchant and a pirate?" It was then that the public needed protection. It is a sorry commentary on the efficacy of democratic government that its right arm was paralyzed by corruption. Now that business ethics have taken a turn for the

better, the hoary prophets rise in bombastic defence of their charges.

Important Distinctions

The fear and fury of the selfless defenders of human rights fail to take certain important distinctions into account. The first is the distinction between money power and money monopoly, and the second, that between co-operation and monopoly.

The Power of Wealth and Monopoly

The power of great wealth requires no exposition. Like fire it may do either good or harm. Our great welfare foundations are impressive evidence of the benefits to which the public has fallen heir. On the other hand we have the example of a Secretary of the Interior "borrowing" $100,000 from a connoisseur of oils to facilitate a transaction which the court characterized as "tainted with fraud." Such a use of wealth leaves a bad taste. It makes ideal demagogic pabulum. Although the example is used to embellish the evil of concentrated wealth, it has in fact nothing to do with the question of credit monopoly. The latter may have manifestations just as vicious as the former. By the same token it may prove just as beneficent. Our point is that the power of great wealth is a problem, if such it be, separate and distinct from that of a credit monopoly.

Co-operation and Monopoly

Our second distinction is that between co-operation and monopoly. Both call for concert and team-play. The difference may be reduced to a matter of the degree of cohesion and unity of control and also possibly to a question of intent. When in November, 1929, a consortium of bankers headed by the House of Morgan, met to check a disastrous drop in the stock market, we had a form of co-operation which in that particular instance bore no peril to the public. When Professor McGibbon discovered that the representatives of the chartered banks met in Winnipeg to decide on rates to be charged to clients he saw the matter in a different light. So likewise did certain members of the Canadian Parliament.[12]

The Nature of Monopoly

Such co-operation is capable of abuse at the expense of the public. Yet it must be recognized that bankers have the right to protect themselves against destructive competition We have granted that right to our own business men through the tolerance of open price trade associations which have introduced a note of wholesome stability beneficial to the public, the worker and the stockholder. Monopoly goes much further than this. In the place of co-operation we have the subservience of

[12] *House of Commons Debates,* June 19, 1923, pp. 4105, 4125.

all the constituent elements to a single arbitrary will. Such unity of direction carries with it control of supply and, within the tolerance of the market, control of the price. The Federal Reserve Board clearly has such power over our gold supply. Organized enterprise as well as the common man is experiencing diminishing contacts with gold. Its concern is with credit. Is it possible for the present concentration movement in banking to proceed to a point where a single individual or small group may say, "This entrepreneurial plant shall have water and may flourish. That plant shall not have water and must die"?

Concentration in Canada

Let us turn to Canada and England for light on this question. The tide of concentration in the Dominion has moved with barely a pause. During the first twenty-five years of the present century the Canadian banks almost doubled in size every five years. In 1905 Canada had thirty-four chartered banks. Today she has ten. In 1905 four banks held 40 per cent. of the aggregate resources of all the banks. Today those same four banks hold 80 per cent. of the aggregate resources. Two of these banks, the Bank of Montreal and the Royal Bank of Canada, account for more than half the banking assets of the Dominion.[13] It must be con-

[13] *Canada Year Book*, 1929.

fessed that the Canadians viewed this phenomenon with some uneasiness. When Parliament pressed its inquiry into banking in 1923 the matter was given attention.

A Canadian Banker on the Ultimate of Concentration

Sir Edmund Walker is on the stand and is deploring the tendency of democracies to interfere with "the natural processes of life." He thinks that the regulation of interest rates and even railroad rates should be left to these natural processes. It is an apt occasion for a question and a member of the committee puts the following query to him,

"And do you suggest that these mergers are in the public interest?"

A. "They enable us to serve the public a great deal better than we would without them."

Q. "Would there be a point beyond which it should not go? For instance there might be a possibility of getting down to one bank."

A. "That is quite possible."

Q. "Would that be desirable?"

A. "I think the result of that would be the establishment of another bank at once. . . . I think several would be started for that matter. I think that would take care of itself at a certain point."[14]

It is interesting to note in this connection that

[14] *Proceedings of the Select Standing Committee*, 1923, p 532.

Barclays Bank of London organized a Canadian affiliate which commenced business in 1929.

Canadian Parliament Imposes Restraints on Further Amalgamations

The assurances of Sir Edmund and his animadversions on the frailty of democracies failed to stir the committee and the Bank Act of 1923 contained certain provisions which Parliament thought would be a trifle more effective than natural processes. The Act requires the consent of the Governor-in-Council, based upon the recommendations of the Minister of Finance and the Receiver General, before a merger can take place.[15] In the United States this procedure would correspond to a recommendation of the Secretary of the Treasury and the Comptroller of the Currency, approved by the President, with the consent of his cabinet. It is significant that six mergers have taken place since 1923.

Canadian Bankers Association Passes Upon New Applicants

In spite of the greater supervision of banking by the state, the superficial aspect of banking in Canada is sinister. The bankers appear to be an exclusive group with the right to pass upon new members and to determine succession. A new

[15] Sections 99-111.

bank seeking to join this circle must apply first to the Canadian Bankers Association, consisting of banks already in the field. The law places this association in the position of passing upon all prospective competitors. The association reports to the Minister of Finance and if the report is adverse the applicant fails to get a charter. It seems, therefore, as if the cards are stacked against the newcomer.

Uniform Practices

There is also a certain uniformity required of all the banks in the association. Some are overt and others are covert. The rates paid upon deposits, the rates charged for loans, and the commissions of various kinds paid for a variety of banking services are practically uniform as between the different banks in any given section of the country.

Some Uniformity in This Country

The reverse side of the shield modifies this impression. In our own country we find approximate uniformity of deposit rates and service charges in any particular community although the banks in that community are independent. As in Canada, our bankers' associations and clearing-house associations formulate rules of bank practice which the great majority of the member banks follow.

Responsibility of Canadian Bankers Association for Failures

Although the Canadian Bankers Association passes upon new members—an extraordinary privilege—there is also the correlative responsibility. There have been very few bank failures in Canada due chiefly to the readiness of solvent banks to assume the liabilities of institutions on the brink of failure. So definite is this responsibility that a Finance Minister stated before a Parliamentary committee that he could force the Canadian Bankers Association to assume the liabilities of a failing bank even though there is no legislative sanction for such a procedure in the Canadian banking laws.[16] "Co-operation" fits the Canadian banking situation much better than "monopoly."

Investor Instead of Depositor Takes the Punishment

While this team-work among the Canadian banks may exact a price and present some unwholesome aspects, it nevertheless provides a measure of compensation. The latter consists chiefly of the assumption of risks by the stockholder rather than the depositor. It is to be noted that in Canada the shareholder bears the brunt — not all — of bank losses. In the United States the inadequate capital structure of many of our banks imposes a certain

[16] Thomas White, *Royal Commission to Inquire into and Report upon Affairs of the Home Bank of Canada*, p. 359.

amount of rough treatment upon the bank depositor. This fact should be kept clearly in mind by the investor who thinks that bank mergers result in greater profits. He should examine carefully the dividend record of the Canadian and English banks.

The Great English Banks

The dominance of the great English banks has long been pressed upon our attention. They have grown even as our own banks are growing through a process of amalgamation and direct expansion. The "Big Five" is no idle rhetorical term. This small group of banks holds more than 91 per cent. of the resources of the joint stock banks of the United Kingdom. Of the banks still remaining outside this circle of Titans, a number are owned by one or another of this group. Their sphere of influence is far flung and profound. They reach to all parts of the globe. Their complementary affiliations through interlocking directorates and stock holdings enable them to direct the course of British trade and industry throughout a vast empire.

English Apprehension

This giganticism has long since disturbed the equanimity of the Englishman. By 1918 it had proceeded to a point where an official inquiry was considered necessary. The Chancellor of the Exchequer appointed a Treasury Committee at the

head of which were Lords Colwyn and Cunliffe. One scrutinizes the committee in vain for a trace of pink. Even an Englishman would grant its conservatism. In view of which we shall permit the committee to speak for itself on the effect of amalgamations upon competition and the danger of monopoly.[17]

The Treasury Committee

"*Dangers of reduced competition.* — Although, in the past, we believe that amalgamations have not, in most instances, led to a reduction of bank competition, yet, as we have pointed out in paragraph 6 (a) above, in London (and possibly before long in certain large towns) amalgamations between large joint stock banks must now usually mean a net reduction in the number of competing banks. It is true that this reduction is only slight in each case, and that there still remain at present a fair number of competing banks. But we have received representations from certain municipal corporations to the effect that banks vary much in their willingness to allow reasonable overdraft facilities to corporations, and that sufficient money, and cheap enough money, has only been obtained hitherto by resorting to different banks, the number of which is now falling steadily. On this ground a number

[17] *Report of Treasury Committee on Bank Amalgamations*, 1918, London, p 6.

of resolutions have been forwarded to us by corporations protesting against further amalgamations, and suggesting that it is not in the national interest that large funds belonging to the public should be in the hands of a few companies.

Effect on Money Market

"Strong representations have, on similar grounds, been made to us on behalf of the Stock Exchange and the Money Market. It is claimed that the world-wide fame of the London Market before the war was due to the freedom with which London bills could be negotiated, owing to the ease with which Discount Houses obtained ample funds from a wide number of banks, and that the fewer the lending constituents in the Discount Market, the less flexible is the market and the less fine the rates. It is added that the number of members in the Clearing House is already becoming very small, and that any further decrease in the number of its constituent members, or any greatly preponderant power on the part of particular members, might impair confidences in its smooth working and raise apprehensions in the market. Moreover, it is pointed out that a reduction in the number of important Banks must mean, and has already meant, a reduction in the number of first-class acceptors of bills, and that if this reduction proceeded very far, it would become a question whether the Bank

of England would not have to place a limit on the amount of acceptances which they would take from any particular bank doing a large accepting business, and whether Continental buyers would not limit the number of bills taken by them.

"*The Danger of Monopoly.*—It has been represented to us that there is a real danger lest one bank, by the gradual extension of its connections, may obtain such a position that it can attract an altogether preponderant amount of banking business; or, alternatively, lest two banks may approach such a position independently and then achieve it by amalgamation.

Danger of Public Control

"Any approach to a banking combine or Money Trust, by this or any other means, would undoubtedly cause great apprehension to all classes of the community and give rise to a demand for nationalising the banking trade. Such a combine would mean that the financial safety of the country, and the interest of individual depositors and traders, would be placed in the hands of a few individuals, who would naturally operate mainly in the interests of the shareholders. Moreover, the position of the Bank of England — which would, it may be assumed, stand outside any such Trust — would be seriously undermined by so overwhelming a combination, and the Bank might find it extremely dif-

ficult to carry out its very important duties as supporter and regulator of the Money Market. Any such result would, in our opinion, be a grave menace to the public interest.

"Further, it has been represented to us that the Government of the day might not find it easy to adopt a course of which the combine, for its own reasons, disapproved.

"While we believe that there is at present no idea of a Money Trust, it appears to us not altogether impossible that circumstances might produce something approaching to it at a comparatively early date. Experience shows that, in order to preserve an approximate equality of resources and of competitive power, the larger English banks consider it necessary to meet each important amalgamation, sooner or later, by another. If, therefore, the argument from size, referred to in paragraph 6 (b) above, is to prevail, it can only lead, and fairly rapidly, to the creation of a very few preponderant combinations; and if those combinations amalgamated, or entered into a joint agreement as to rates and policy, &c., the Money Trust would immediately spring to birth."

A Comptroller Sees Danger of Monopoly in this Country

What has been the reaction to the danger of monopoly in this country? In the 1923 report the Comptroller of the Currency, Henry M. Dawes,

called attention to the danger of monopoly inherent in an extension of the branch banking system. Arguing from an analogy with other countries he contended that the ultimate of concentration was inevitable. Mr. Dawes maintained that a tolerance of great branch systems would sound the death knell of the independent unit bank.[18] Experience in other countries indicates that the two cannot exist side by side. Furthermore, he saw the economic future of American communities placed at the mercy of great banking systems. By arbitrary decisions a distant management could determine the flow of funds from community to community. If it should decide that the assets of the system might better consist of commercial paper than farm notes there might result a more liquid portfolio but at the price of rural development.

Effect of Great Banking System on Community Life

"The bank would have the power to retard or to encourage the development of a given community or individual enterprise. In this connection it has been well said that if the sudden creation of great branch banking systems resulted in withdrawing funds from the support of rural communities in order that they may be invested in self-liquidating commercial paper originating elsewhere, then it will be true that sound abstract banking principles will

[18] *Report of Comptroller of the Currency,* 1923, pp. 9-10.

have been applied, but at a cost to the future development of the rural communities that will far outweigh any advantages that may be gained." [19]

A View Not Entirely Warranted

This seems to be an unwarranted view of the dangers threatened by the development of branch systems. We have already conceded elsewhere that the expansion of branch banking would constitute a wet blanket upon the spirit of petty enterprise and that the substitution of the branch manager for the independent bank president would deprive American community life of an influence whose value could not be measured. That the farmer in a land where no other class is as articulate politically, should suffer because of inadequate credit is scarcely supported by the facts. While branch banking may impair the ability of the banking system to adapt itself to the peculiar character of the farmer client this has already been compensated for in part at least by other and wholly extraordinary measures taken by the state.

Statutory Provision for Farmer

Congress has provided a royal road to credit for the farmer. Farm paper has the right to remain in the portfolio of a Federal Reserve Bank for nine months. It is a privilege not shared by other paper.

[19] *Ibid*, p 10

In 1916 Congress created twelve Federal Land banks and encouraged the organization of private joint stock land banks. Uncle Sam contributed about 99.8 per cent. of the original capital of the Federal Land banks. The Joint Stock Land banks and the Federal Land banks both had the right to sell tax-exempt bonds, the proceeds of which were loaned to farmers at rates not exceeding that carried by the bonds by more than 1 per cent. In 1923 twelve Intermediate Credit banks were organized, all of the capital of which was subscribed by the Federal Government. In 1929 the Farm Marketing Act was passed which set aside a half billion dollars in the Federal Treasury to help the farmer achieve parity with industry through a stabilization of the prices of farm products. The money loaned to co-operatives could not bear interest exceeding 4 per cent. The farmer has virtually been granted a latchkey to the nation's credit and the plea that he may suffer as a result of branch banking fails to stir any sympathy in this bosom.

Anticipating the Danger

Congress is not unmindful of its duty in the premises. It would hardly neglect such a succulent political issue as the possibility of a "money trust" presents. A number of bills dealing with the subject have already been introduced.

Proposal of Representative McFadden

Representative McFadden has introduced a measure [20] designed to provide more effective supervision of chain and group banking. He would concentrate the function of examination of all banks which are members of the Federal Reserve System in the Comptroller's office. The measure includes the supervision of "affiliated corporations" which is designed to cover holding companies.

Representative Goldsborough

Representative Goldsborough believes in positive measures. It will be recalled that he introduced the Goldsborough Bill in 1922 [21] which was the legislative embodiment of Irving Fisher's compensated dollar. His bank bill [22] would deprive all national bank shares held in trust or owned by a corporation of all voting rights, would prevent any bank or corporation owning stock in a state member bank of the Federal Reserve System from voting such stock. Finally he would impose a tax of two cents per $100 on every check drawn on any bank which establishes an additional branch or any bank more than 25 per cent. of whose stock is owned by any corporation.

[20] H. R. 7966, 71st Congress, Jan 6, 1930. For a more complete description of banking measures in the 71st Congress see *Journal of the American Bankers Association,* February, 1930, pp 741, et. seq.

[21] H. R. 11788, 67th Congress, 2nd Session.

[22] H. R 8363, 71st Congress, Jan 2, 1930.

Representative Strong

Representative Strong, whose name is also associated with the movement to stabilize prices by legislation,[23] has introduced a bill to prohibit group or chain banking.[24] Mr. Strong refuses to compromise with errant banks which insist on selling their birthright. A national bank which is member of a group or chain must forfeit its charter. If the offending institution is a state member bank it will forfeit its stock in the Federal Reserve bank. Finally any bank branded with the guilt of association with other banks will be denied the use of the mails, and the transportation of any commodity or article in interstate or foreign commerce.

Representative Beedy

On the other side, and far more moderate and rational in tone than the last two proposals is one by Mr. Beedy [25] authorizing national banks to acquire or establish branches within a Federal Reserve District subject to the regulations of the Comptroller regarding capital and surplus. It also admits state banks to membership in the Federal Reserve System without reference to the location of their branches. Finally it grants the Comptroller the power of inspection and examination of any corpo-

[23] H. R. 7895, 69th Congress, 1st Session, March 24, 1926.
[24] H R 8367, 71st Congress, Jan 9, 1930.
[25] H. R. 8005, 71st Congress, Jan. 6, 1930.

ration which owns or controls a majority of the stock of more than one member bank.

Fear of Monopoly Abating

In spite of the extreme measures proposed by Representatives Goldsborough and Strong the public fear of monopoly is less evident than in the past There is a feeling that the concentration movement is inevitable and the natural concomitant of similar movements in other fields. It is rather difficult for the common man to see why the banks should be singled out for repressive legislation not directed to other forms of concentration. He is unable to see why large units or multiple units in banking should hazard his peace and joy any more than the United States Steel Corporation or the chain stores. Finally he is persuaded that a higher standard of business ethics prevails today and that a degree of concentration which might have jeopardized his welfare a generation ago is today either innocuous or fraught at the worst with negligible peril. How much headway our atavistic representatives will make against this sentiment is uncertain. That they will struggle desperately to make an issue of it seems assured.

CHAPTER XIII

Banking Concentration and the Federal Reserve System

The creation of the Federal Reserve System was the reply of American unit banking to the highly centralized systems of other nations. The latter possessed certain virtues whose absence we felt keenly. Our banking army was scattered over 25,000 posts. There was a certain unity and cohesion among the stronger elements but the system functioned awkwardly with an appalling waste of energy. The facility with which it collapsed in times of stress gave the nation a feeling of insecurity and inadequacy which the integrity and skillful conduct of individual banks could not allay. Our gold reserves, impressive in the aggregate, when scattered among thousands of banks with no scheme or assurance of co-operation in a crisis, failed utterly to stem those periodical credit debacles which afflicted the nation.

Inelasticity of Credit

In addition to the impotence and inadequacy of our gold reserves, there was the inability of our

system of banks to adjust their credit accommodations to the changing needs of enterprise. There were occasions when the land required more credit and could not have it and others when the banks had too much credit and could not use it. Then there was the immobility of our banking funds. We have already called attention to the crude devices by which we sought to render the redundant funds of one community available to another in want. The channels through which the funds moved laboriously from place to place were cluttered with obstructions, costly in the end to the borrower and detrimental to the lender. The centralized banking systems of other nations, in many ways not as far advanced economically as we, possessed the three cardinal virtues of a banking structure, economy of gold reserve, elasticity of credit and mobility of funds. Our own lack of them embarrassed us directly through costly and inefficient credit service and indirectly by undermining our pride and confidence in the system.

Our Defects the Result of Unit Banking

Be it remembered that this situation would not have existed if banking in this country had developed as it did in Canada and England. It was the penalty which America paid for unit banking. In order to preserve the advantages of the latter and sweep away those defects which constituted a re-

proach to our banking organization, we created a system of super-banks. These banks centralized our reserves. They imparted an elasticity to our credit and currency which equalled, if it did not excel, that of any other nation. They made possible a mobility of capital and credit which had been the envied attribute of the concentrated banking systems of other nations. The Federal Reserve System, in other words, fortified the unit banks of this country in such a way that they were able to provide their clients with a type of service as comprehensive and competent as that of the great banks of Canada and the continent.

Shall We Reject the Remedy?

This political adaptation of our small independent banks to the requirements of a complex industrial society appears now to be in a process of rejection. Are the banks through concentration about to repudiate the instrument painstakingly created for their benefit? Is it a displacement that we may view with indifference? Shall we invoke the grand old 100 per cent. American expedient and do something about it?

Reserve System as Ideal Embodiment of Centralization

We have already alluded to the position of former Comptroller Henry M. Dawes. He held that the Federal Reserve System is an ideal correla-

tive in the field of banking to our political organization. It provides for centralization of those functions of a banking system which may best be administered from Washington and permits local autonomy in those matters which had best be left to local discretion. It assures a "regulated cooperation of banking facilities."[1] To deny or destroy this instrument would be a step backward in our banking development.

Position of Comptroller Dawes

He then proceeds to show that the development of a great banking system within this system, usurping the very functions which the Reserve banks had been created to discharge, would gradually emasculate and finally dominate the central bank. These great branch systems would be in a position to make demands and exert an influence which would subvert the capacity of the Reserve banks to serve the public in the manner intended by law.

Finally Mr. Dawes sees an element of real danger in that stage of amalgamation when but five or six mammoth banking systems operate in the land. It is unreasonable to suppose that these banks, now limited in number, will not act in concert on occasion. Such concert will not always be in the public interest. When the Reserve system has been forced into a subservience from which it

[1] *Annual Report of Comptroller of the Currency,* 1923, pp. 8-9.

cannot escape, then America will be called upon to pay the penalty.

Colors too Dark

One may be permitted to question the substance of these fears without impeaching the validity of many of the criticisms which Mr. Dawes has made of the branch banking trend. There is little evidence that popular liberties or economic progress have been sacrificed upon the achievement of extreme concentration in other countries. Our examination of banking health in this country has demonstrated the dependence of the banks upon the prosperity of the communities which they serve. It would be the ultimate of stupidity for the management of great banks to adopt any policies inimical to the public weal. The giant banks of other nations fully appreciate their dependence upon popular support and favor. The banker is merely the toll-master standing on the highways of economic progress. He facilitates the movement and in return wins the guerdon of profit. Should he comport himself in such fashion as to retard the teeming tide that flows by he would himself suffer. Any stagnation of the productive processes of community life would be reflected inexorably upon the banker. Whatever his faults of morality and intelligence may be, he at least recognizes his inseparable identity with those whom he would serve.

Fear of Public Control

The second factor which would give pause to any vicious aspirations for unwholesome domination is the fear of public control. We have elsewhere called attention to the high moral ardor of our political loudspeakers from the great commonwealths of the South and the West. They would extirpate speculation. They would solve the refractory enigma of the business cycle by bureaucratic ukase. They would determine price levels by administrative fiat. These worthy aspirations suffer today from certain practical impediments. The factors are too multifarious and complex. If our 25,000 banks, however, are reduced to a dozen, let us say, that would help matters. One can deal with 12 banks whereas 25,000 will check the energy and obscure the intelligence of—well—even Senators.

Public Control in Other Lands

However, the danger of public control with undue concentration is real. The Canadian banks have been compelled to submit to it.[2] The Colwyn Committee called attention to this hazard in 1918.[3] State control is a fact in Italy[4] and to a lesser extent

[2] Amendment to Canadian Bank Act, July 19, 1924.

[3] *Report of the Treasury Committee on Bank Amalgamations*, 1918, p 7.

[4] Willis and Beckhart, *Foreign Banking Systems*, pp 783-785

in France[5] and Germany.[6] The situation, therefore, carries promise of an unpleasant conflict. On the one hand, there is the danger to the integrity and efficacy of the Federal Reserve System. On the other, there is the possibility that the small unit banks of today, in handing over their independence to chains, are in fact preparing the way for greater state participation in the business of banking. The latter is a greater evil than the former and is likely to follow it.

A Climax in View

The problem today is being brought to a head partly by the precipitate pace of the concentration movement and partly by the conflict between state and Federal banking codes. The movement toward greater unity of control is striving to proceed within the law wherever possible but without the law where necessary. The latter does not mean illegality. Rather it refers to the adoption of unifying corporate devices which will achieve unity and be legal at the same time. Chain and group banking, saving only where joint control seeks to avoid the liabilities attaching to such control, are merely substitutes for branch banking. The Federal law severely checks branch expansion within

[5] The "Big Four" in France are actually quite free from governmental control or supervision The state makes its influence effective through the Bank of France with its 600 branches.

[6] The various German states are to a limited extent engaged directly in the banking business through state banks.

municipalities of less than 100,000 population and permits expansion in greater communities only within corporate limits of the town or city and with the permission of the Comptroller of the Currency. This tolerance is granted only in states which suffer at least a similar degree of branch banking.[7] No state can permit branch banking beyond its own borders. National banks are therefore virtually limited to the urban area in which the main bank is located unless they are converted state banks in which case they may retain such branches as they possessed on February 25, 1927.[8] The borders of a state then constitute the outer limits of a branch system. Through the holding company device or a community of interest among stockholders the movement toward greater banking units is going forward in spite of the law.

We have referred to the conflict between state and Federal codes. The conflict does not consist of any direct opposition between the two but rather in the greater latitude which some of the state laws permit to the bank ambitious to expand.

Prohibition of Branch Banking Does Not Prevent Concentration

It should be noted parenthetically that the states which have outlawed branch banking have

[7] *Digest of Rulings of the Federal Reserve Board,* 1914-1927, p. 323

[8] Date of passage of McFadden Act, Section 5155, Revised Statutes of the United States

forced the concentration movement to take a form which gives less protection to the depositor. A group of banks united by a holding company device are united as to assets and income and separate as to liabilities and losses. The earnings of each bank in the group are passed on to the holding company and by it distributed to the stockholders. The assets and business of any bank in the group may be reapportioned to suit the judgment of the management of the group. If such a bank should fail, however, it would do so without contaminating the assets of the other banks. It would fail alone. It could be cut off like the dead branch of a tree leaving the rest of the system to flourish. Furthermore should the creditors of such a failed bank have recourse to the double liability of the stockholders they will be confronted by a corporate entity instead of a mortal shareholder. The latter has exchanged his share of stock in the particular bank for a share of the holding company. He has therefore divested himself of double liability and double liability seems to be the obligatory attribute of an individual and not a corporation. It would seem that the interests of depositors would be served better by the tolerance of branch banking.

Deflecting the Form of Concentration

This is well illustrated by an examination of the situs of chain developments. The nine states

and the District of Columbia which permit state-wide branch banking had forty-nine banks in chain systems on June 30, 1929. The eleven states in which branches are restricted as to location had 337 in chains. The twenty-three states which specifically prohibited branch banks had 1026 banks in chain systems. Even if we make allowances for differences in the number of states in each group and variations in population in each group this confirms the belief that the chain organization has been adopted as a legal subterfuge in many cases rather than as a means of evading the greater responsibility of the branch organization.

Branch Appeal Not Strong Enough to Lure Banks Out of Reserve System

The states which permit unrestricted branch banking offer a definite appeal to the bank which wishes to grow via the branch method. While this may in time become a factor affecting membership in the Federal Reserve System, there is little evidence to show that it is so operating at this time. As between sacrificing membership in the system and acquiring state-wide branches on the one hand and remaining in the system and expanding through the looser affiliations of common stock ownership, on the other, the latter appears, so far at least, to be the more attractive alternative. The value of the Reserve system for the great bank

seems to be definitely established. It is the small bank which has been unable to find in that membership adequate compensation for the cost involved.

System Affected in Two Directions

The Federal Reserve System has less to fear from the departure of the great banks than from a gradual enervation due to the ability of the banks to defeat directly or indirectly the intent of the directing body. This evasion of central bank pressure runs in two directions, the first dealing with the negative powers of the central bank and the second with its positive powers. The former is effected through an increasing impotence of its visitorial capacity and the latter through a nullification of its efforts to control the course of credit.

Greater Banks and Supervision

How will a limited number of great banks affect the capacity of the central office to continue adequate examination and supervision? In no other land has the supervisory regulation of the state been as painstaking—or—as necessary as in this country.[9] The English banks are still examined by an introspective process. Self-inspection has been tolerated because the great English banks have demonstrated the justification of that confidence through an apparent immunity to failure. Should

[9] With the possible exception of Italy

any of these banks fail it is quite certain that the state will assume the duty of supervision but lately claimed by the Canadian government.

Canadian Experience

The Canadian experience is of interest to the American. Conditions in the two countries are very similar and the writer pleads the light which that experience may cast on our own problems in justification of the repeated and extended reference to Dominion banking.

Up to 1924 the chartered banks of Canada did their own inspecting and successfully opposed any attempt on the part of the government to provide official examination. The banks of Canada to a degree unknown in this country had managed their own affairs and were ill-disposed to grant the state the right of inspection. Nor was the state very enthusiastic about the prospect or vigorous about the necessity of examination. Although there had been widespread agitation for greater governmental supervision since the opening of the century the bankers regarded the step as an unwarranted invasion of their rights. It was a check upon individual initiative and productive of great mischief even as it was destined inexorably to failure. In fact the rigid inspection of American banks which most Americans, including the bankers themselves,

had always considered very salutary, was cited as the certain sign of the decadence of American institutions.

The Home Bank

All this stalwart opposition, plus the indifference of the government, melted away when the Home Bank failed in 1923. The commitments which eventually proved fatal to this bank had been made during the war and boom period which followed it. The Canadian Finance Minister, under cross-examination of a Parliamentary Committee, candidly confessed an inability, in the face of all his other duties, to provide that supervision which in this instance might have averted failure.[10] This is the only failure which has been permitted to take place in Canada since the war. The condition of the bank had become so bad that no member of the Canadian Bankers Association could be made to assume its liabilities.

It was a singular fact that the Home Bank had conscientiously provided that audit which common prudence dictated but the auditors, two in number, had been officials of the Home Bank for many years. They could not bring to their task that disinterested severity and critical judgment which an independent audit provides. As little could they

[10] Royal Commission, *Home Bank of Canada*, 1924, pp 381-2

provide an effective audit as a schoolboy could provide an examination for himself.

Difficulties of Proper Examination

In 1924 the Governor-in-Council, on the recommendation of the Minister of Finance, appointed the first Inspector General of Banks. The task of examining a bank with hundreds of branches scattered over a wide area offers a forbidding prospect to the examiner. However, it was felt that a capable inspector in possession of the reports of a bank's own auditors and having access to the main office and the principal branches was in a position to judge if the bank was in a sound condition. This official makes an examination of every bank at least once a year. It is impossible to say how effective this supervision is. Since the appointment of the Inspector General no failures have taken place among the Canadian banks. The definition of failure, however, is technical and narrow. During the period of five years, 1924-1928, four banks[11] were absorbed by stronger institutions and, if we recall the legal restrictions upon amalgamation in the Dominion, it is a fair conclusion that these banks would not have been permitted to surrender their identity had they not been well on the road to failure.

[11] The Financial Post, *Business Year Book*, Canada and Newfoundland, 1930, p 165.

Conflicting Views in This Country

As to the problem of proper examination in this country, there are three official views available, only two of which we can cite specifically. Henry M. Dawes as Comptroller of the Currency saw in the development of vast branch systems a serious impediment to effective examination.[13] John W. Pole, in a similar capacity, saw in that development a distinct aid to the task of inspection.[14] The two views are separated by six years. It is hardly possible that both can be correct. It happens that the subordinate officials of the Comptroller's office actually charged with the task of examination do not share their chief's sanguine views. The examination of the great banks in New York, these officials confess, has become a task of trying magnitude. It is necessary to mobilize the entire visitorial staff of the Comptroller's office, the Federal Reserve Bank of New York and the examiners of the New York State Department of Banking to cover the various members of a single system at the same time. Since these examinations to be effective must be made without the prior knowledge of the bank, it can readily be seen that the task of launching a projected examination becomes increasingly difficult with size.

[13] *Annual Report of the Comptroller of the Currency*, 1923, p 9.
[14] *New York Times*, February 26, 1930

CHAINS AND BANKS IN CHAIN SYSTEMS, BY STATES
JUNE 30, 1929

State	Chain systems: Total	of 3 banks	of 4 banks	of 5 banks	of 6-9 banks	of 10-14 banks	of 15-19 banks	of 20-29 banks	of 30-39 banks	Banks in chain systems: Total	National	State
Total	230	37	45	31	82	21	9	3	2	1,561	596	965
State-Wide Branch Banking Permitted												
Total	8	1	2		4	1				49	25	24
Arizona	1				1					6	1	5
California	4		1		2	1				30	20	10
Delaware												
Dist of Col												
Maryland												
N Carolina												
R Island	1	1								3	1	2
S Carolina												
Virginia												
Wyoming	2		1		1					10	3	7
Branches Restricted as to Location												
Total	61	18	16	8	14	1	3	1		337	135	202
Kentucky	1		1							4	4	
Louisiana	2		1		1					10	6	4
Maine	1			1						5	2	3
Massachusetts	4		1		2		1			33	19	14
Michigan	11		5	3	1	1	1			71	3	68
Mississippi												
New Jersey	12	8	1	1	2					49	22	27
New York	17	4	4	2	5		1	1		111	58	53
Ohio	1				1					6	3	3
Pennsylvania	9	4	2	1	2					38	12	26
Tennessee ...	3	2	1							10	6	4

CHAINS AND BANKS IN CHAIN SYSTEMS, BY STATES JUNE 30, 1929

State	Chain systems: Total	of 3 banks	of 4 banks	of 5 banks	of 6–9 banks	of 10–14 banks	of 15–19 banks	of 20–29 banks	of 30–39 banks	Banks in chain systems: Total	National	State
ESTABLISHMENT OF BRANCHES PROHIBITED BY LAW												
Total	141	17	25	20	54	17	4	2	2	1,026	365	661
Alabama	3			1	1	1				22	11	11
Arkansas	4			1	1	1			1	63	13	50
Colorado	2			1	1					13	8	5
Connecticut												
Florida	4		1		2	1				32	13	19
Georgia	6	2	3	1						23	8	15
Idaho	3		1		1	1				23	7	16
Illinois	11		3	1	5	2				81	20	61
Indiana	1	1								3	2	1
Iowa	12	2	4	1	1	3	1			92	33	59
Kansas	10		2	3	5					55	15	40
Minnesota	34	1	2	6	18	4	2		1	279	130	149
Missouri	4		1		3					26	7	19
Montana	2				2					15	4	11
Nebraska	9		2	1	5	1				63	15	48
Nevada	2	1				1				14	2	12
New Mexico	1				1					6	4	2
Oregon	6	3	1		1	1				32	14	18
Texas	6	1	1	1	2	1				37	7	30
Utah	5		1		3			1		50	12	38
Washington	11	5	1	2	2			1		62	26	36
W Virginia												
Wisconsin	5	1	2	1			1			35	14	21
NO PROVISIONS REGARDING BRANCH BANKING												
Total	20	1	2	3	10	2	2			149	71	78
N. Hampshire												
N Dakota	7	1		1	2	2	1			60	20	40
Oklahoma	8		2	1	4		1			59	41	18
S Dakota	5			1	4					30	10	20
Vermont												

California Practice

In California this difficulty has been avoided by treating each branch as a separate institution.[15] Within a branch, moreover, each department is treated as a distinct banking unit. Thus the savings department, the trust department and the commercial banking department of a single branch are presumably treated as distinct banking entities. The inter-relation of banking functions is such that this seems like a visitorial fiction, an expedient born of the difficulty of proper inspection.

Our conclusion on this point is that the negative powers of the central bank, *i. e.,* its powers of supervision and examination, will suffer in effectiveness as our banking units grow in size.

Central Bank Functions

Our answer on the positive side must await a brief analysis of the functions of a central bank. These may be divided into three categories. The first consists of duties which are fundamental and vital to the existence of the banking system. Such are the provision of elastic credit supplies, mobility of credit and the maximum economy of gold. The second category consists of subordinate banking functions. They relate to improved technical operation of banking. We may include in this group

[15] See *United States Daily,* March 20, 1930.

an improved clearance system for checks, the more effective and less disturbing discharge of governmental fiscal duties and finally adequate credit facilities for foreign trade. Our third group of functions relates to those broad and idealistic aspirations of central banks which call for a body of supermen as directors endowed with the pure ethical probity of angels. In outline form this functional analysis looks somewhat as follows:

Vital Banking Functions

1. The assurance of elastic credit.
2. Complete mobility of credit.
3. Conservation of gold.

Subordinate Banking Functions

1. Improved clearance of checks.
2. Effective fiscal service for the state.
3. Foreign trade credit facilities.

Idealistic Banking Functions

1. Stabilization of prices.
2. Elimination of speculation.
3. The prevention of business recessions.

Normal Functions

The first six duties of a central bank have been discharged by the Federal Reserve System with gratifying effectiveness during the course of its existence. These duties are tolerably well suited to governmental administration. They are routine

in character and require little initiative or discretion. Within limits they are largely automatic and once the mechanism is established it would operate smoothly no matter what the personnel of the directing board might be. Fortunately the appointees to the board have been honest and conscientious and any errors made have been the result largely of political pressure. It follows that any great private bank with the same legislative sanction could discharge the duties of a central bank as effectively as has been done by the Federal Reserve Board and the twelve Reserve banks. The Bank of England is an excellent case in point.

Concentration and the Discharge of Normal Central Bank Functions

To what extent would the existence of a limited number of large banks impair the ability of a central bank, private or political, to discharge the vital and subordinate banking functions? In these six objectives of central bank policy it is difficult to discover any conflict of interest whatsoever between either large or small private banks and the central bank. The interests of the two are thoroughly identical. Let us consider these functions briefly.

Elastic Credit

The bane of our old unit banking system prior to 1914 was its incapacity to adjust credit to the

needs of trade. Each bank's capacity to serve its community was limited by its capital and its reserves, a limitation modified only by its alliances with greater independent banks in the big cities. Through these associations a certain pooling of credit resources was effected but it was crude and awkward compared to the co-operation made possible by the advent of the Federal Reserve System. Each season had certain peculiar peak demands for credit even as certain years in each cycle displayed an exuberance not shared by other years. It is the task of an effective credit system to adjust its supplies of funds to the changing needs of seasons and cycles. In a country where agriculture still plays an important role, our peak demands for credit occur in the spring and the fall. With a comparatively inflexible credit supply business was necessarily cast in the unpleasant role of Procrustes. The Federal Reserve System, through the rediscounting privilege granted to banks, the creation of a bill market and the flexible ratio of gold to credit and currency, altered this for the better. These advantages inure to the benefit of the great bank as well as the small.

Credit Mobility

In the matter of credit mobility there was again a lack of organization. The Boston district might have ample funds while Atlanta was in an impecu-

nious state. After a bit and in various devious ways funds might seep from Boston to Atlanta but the process was slow and costly. The Federal Reserve System has served to pipe the credit markets of the country into a single connected system so that an excess in one market can flow freely to another. The credit reserves of each district are centered in the Federal Reserve Bank. This enables it to take care of any inequalities within the district. As between regions the Board may compel one Reserve bank to discount the paper of another, thus assuring a flow between districts. During the critical period of 1920-1921 the Reserve banks of St. Louis, Minneapolis, Kansas City and Dallas benefited from inter-bank accommodation.[16] At one time in the fall of 1920 the reserve ratio of the Dallas bank dropped below 10 per cent. Certainly in the discharge of this duty greater banks can furnish no ground for apprehension.

Gold Conservation

Perhaps the most striking service of the Federal Reserve Bank, considered by some students its most important service, is the concentration and conservation of our gold supplies. Instead of being scattered in thousands of isolated vaults throughout the country the greater part of it now reposes in

[16] See *Joint Commission of Agricultural Inquiry*, Report, Part 2, p 90

Washington. There it rarely sees the light of day. Changes in ownership are effected through transfers in the accounts of the owners. That results in definite physical economy and eliminates the float in the supply, *i.e.,* there is practically no gold in transit. Due to the fact that $40 of gold in the vaults of the Federal Reserve banks can support $100 in currency while $35 can support the same amount of Reserve credit the efficiency of the yellow metal as a base for member bank credit has been materially increased. Such economy is also one of the objectives of banking concentration and the central bank in the discharge of this function is serving the interests of the great bank as fully as it is complying with the intent of the statute.

Subordinate Functions

The point we have made concerning the three major functions of the central bank applies also to the subordinate functions. This is not a treatise on central bank practice. It is not the proper occasion for an extended examination of the Federal Reserve System. The inquiry is justified only to the extent that the development which is the major thesis of this study, namely, the growing stature of our banks, actually modifies the ability of the central bank to carry on its traditional duties. There is no evidence that greater banks will in any way impair the capacity of the Federal Reserve banks

to perform those technical services which constitute the subordinate functions of the central bank. In fact there is some slight reason to believe that fewer banks will facilitate the clearance of checks, the efficient performance of fiscal services for the state and the creation of better credit conditions for foreign trade.

Concentration and Idealistic Central Bank Functions

It is in the discharge of those idealistic functions of the central bank which comprise our third category that the great bank as contrasted to the small bank may exercise a profound influence. Be it noted that the six functions which we have synthesized into the traditional role of the central bank are essentially passive roles. They depend upon an organization established by law and a procedure limited by law. The objectives are within definite reach of those powers which the law-making body has bestowed upon the central board. The conservation of the gold supply, for example, operates automatically through the requirement that member banks maintain their reserves with the central bank and the refusal of the law to recognize as reserves anything but deposits in a central bank. It is the law, therefore, which charts the course of gold centralization. The Federal Reserve Board and the twelve banks are merely the passive instruments wherewith the end of the law is effected. The poli-

tics, the experience or the intelligence of the personnel which mans these instruments can hardly modify the efficacy of their service. As long as a central bank remains within its traditional bounds it is ideally suited to bureaucratic administration. If the officials charged with its conduct are able and intelligent that may provide some comfort but it really does not matter a great deal. However, when the central bank under spontaneous inspiration or the pressure of over-zealous friends or the intimidation of sectional advocates reaches out to seize powers of broad social import the situation at once becomes charged with an entirely different significance.

Price Stabilization

Certain students of price changes gifted with an wholly exceptional perception of the dire consequences which such changes visit upon mankind implored Congress to compel the Federal Reserve Board to embrace the obligation to maintain commodity prices at a stable general level. Erroneously they attributed certain disastrous changes to the Board. The commodity deflation of 1920, according to these students, was brought about by the deliberate policy of the American central bank. If the powers of the Board applied to a maleficent purpose were so great then they should be equally potent in the realization of beneficial ends. Briefly

it was proposed that the Board should adopt as its basic formula one of the most controverted dogmas of economic theory, *i.e.*, that there is a specific and measurable relation between the quantity of credit and money, on the one hand, and the general price level, on the other. It would follow then that any increase in the purchasing power media of the country would cause prices to rise and any decline would cause them to fall. This is the philosophic kernel of the numerous legislative proposals for stabilization which occupied a large part of the time of the Committee on Banking and Currency of Congress during the period 1923-1928.[17] Legislative pressure was not great enough to compel the Federal Reserve System to assume such a dubious obligation and the wisdom which dictated its rejection must be commended.

Control of Speculation

During 1928 and 1929 the ardor which had maintained interest in stabilization of commodity prices was transferred to a more quixotic venture. Certain statesmen in the upper house of Congress discerned symptoms of financial degeneracy in New York City. The gentlemen who viewed the situation with such audible alarm hailed for the most part from bucolic areas of the interior whose purity

[17] For a full account of this campaign and an analysis of the practical and theoretical problems involved see Lawrence, J S, *Stabilization of Prices*, Macmillan Company, 1928.

was far removed from the corrupting influence of the New York stock market. Almost without exception the Senators who called attention to the nation's peril were identified with two other mighty crusades destined to improve the lot of man, prohibition and farm relief. The Federal Reserve authorities were advised in words that leaped into space that a sorry state of speculation existed, that something should be done about it, that they were the instruments of salvation and retribution. It is a matter of history that they proceeded to do something about it.

Doubtful Justification for Action

Without the justification of imperilled reserves, without any increase in the total of bank credit beyond that which the normal growth of the country and the high state of business activity would cause, without any inflation of commodity prices, the Reserve authorities employed their full statutory powers and some to which their title was not so clear in a desperate effort to bring the stock market to its knees. The discount rate was raised successively until it touched levels not reached since the trying days of 1920-1921. The Reserve banks emptied their portfolios of bills and Government securities to force the member banks to rediscount and then chided them severely for doing so. Pressure was brought to bear upon particular banks

whose speculative turpitude was suspected. Finally the full power of the press was invoked to bring the true faith to an unenlightened and unchastened community. The response of the stock market was similar to that of the fabled traveller whom the wind would fain have forced to doff his coat to prove that he was mightier than the sun. In both cases the object of attention refused to accede to blasts of air though directed at him ever so vigorously.[18]

The Change of Policy

Came the summer of 1929. The pace of business slackened. The farmer was about to harvest his crops in the face of a market prospect that was not reassuring. Speculation still raged on, unabated and impenitent. Business, but especially the farmer, required easy money. The stock market deserved higher punitive rates. How could the Reserve authorities travel in two opposite directions at the same time? Their genius was equal to the task. On August 9, 1929, the Federal Reserve Bank announced a decrease in acceptance rates from 5 1-4 per cent. to 5 1-8 per cent., thus making money easier for the farmer. At the same time it put into effect an increase in the discount rate from 5 per cent. to 6 per cent., thus discouraging speculation.

[18] For a statement of the sequence of events in this notable experiment, see Lawrence, J S, *Wall Street and Washington*, Princeton University Press, 1929

Killing Two Birds

The central bank funds obtained through the sale of acceptances at 5 1-8 per cent. were just as effective in supplying bank reserves as the funds obtained from the rediscount of paper at 6 per cent. The situation is similar to that of a theater which has two entrances, both of which lead to the same seats within with equal facility. If the management should suddenly decide to charge $5 at one entrance and $6 at another through which portal would the crowd flow? Would the $6 admission which no one is now paying exclude certain elements which the management does not welcome but which, because of the nature of the inrushing audience, it cannot selectively debar? These questions need not be rhetorical. Let us see what happened to Reserve bank credit during the period from the first part of August to the middle of October just prior to the crash in the stock market.

Effect on Member Bank Reserves

The reserves of the member banks are affected by changes in the investment portfolio of the Reserve banks (through changes in bills or Government securities held) through rediscounts of member banks, through changes in the subscriptions which member banks have made to the capital of the Reserve banks and finally through changes in the volume of currency outstanding. The follow-

ing table shows the changes which took place in these items during the period under consideration and the effect of these changes on the reserves of member banks.

CHANGES IN ITEMS OF FEDERAL RESERVE CREDIT, AUGUST 7 TO OCTOBER 16, 1929[19]

(000 omitted)

	August 7	October 16	Changes
Bills purchased	$79,158	$360,110	$280,952*
Rediscounts	1,064,070	848,935	215,135†
Paid in capital	165,045	166,998	1,953†
Federal Reserve notes	1,811,038	1,859,621	48,583†
Net increase			$15,281
Net gold imports during period			31,658
Decline in total currency in circulation during period			38,700
Total increase in member bank credit at Reserve banks during period			$85,639

*Increases credit †Decreases credit

The new policy of the Reserve authorities, therefore, enabled the member banks to reduce their indebtedness by approximately 20 per cent. and increase their reserve accounts by $85,000,000. The member banks as a whole can extend about $15 of credit to their own clients for every dollar of reserves at the central bank. This anomalous and original credit policy increased the credit capacity of the member banks by one and a quarter billion dollars during a two and a half months' period. On

[19] Taken from weekly statements of condition of twelve Federal Reserve banks.

the eve of the stock market crash call money ruled at 6 and 7 per cent., the lowest rates of the year. We experienced the phenomenon of a speculative debacle without credit constraint. The informed guidance and delphic judgment of the authorities were universally acclaimed. The experience left the Reserve board with a new lien upon the affection of the American people.

"She Loves Me, She Loves Me Not"

The central bank had disavowed both its capacity and inclination to stabilize commodity prices. With whole-hearted vigor it shouldered the responsibility of checking the speculative ardor of the American people. It had refused to pass judgment on the economic propriety of commodity prices. It acknowledged a duty to pass judgment on the economic and moral propriety of stock prices. To what extent the latter decision was due to an immaculate consideration of financial and economic factors and to what extent to a sycophantic subservience to senatorial Parsifals will remain forever in doubt. The question still remains. Shall a bureau in Washington be charged with the regulation of the speculative manifestations of the American temper?

Afield in Utopia

The responsibility of the central bank for commodity price stabilization and for the correction and

prevention of stock market excesses has led to the imputation of additional obligations which take us still further into Utopia. Modern economic society has contended against periodic fluctuations in activity and well-being commonly known as the business cycle. These irregular sequences of moderate boom, depression and recovery phases have challenged the attention of thinkers since they were first noted. Hundreds of explanations have appeared in print, ranging all the way from the peculiarities of solar radiation and variations in the birth and death rates to pure illusion. Among the more popular theories are those which relate the periodic aberrations of business to credit factors. If, then, changes in the state of our business health are due to changes in credit conditions and the central bank controls credit conditions then it follows logically that the central bank is responsible for the varying fortunes of the business community. Something should be done about it.

The Point of Conflict Between Great Banks and the Central Bank

It is in the attempt to extend its authority to include these three duties of perfection that a conflict is likely to occur between the central bank and the member banks, a conflict in which the great size of the latter may have some bearing on the outcome. It should be noted that the nature of control neces-

sary in the "achievement" of these three ends differs vastly from that necessary to the realization of the more prosaic but time confirmed objects of central bank policy. The attempt to regulate commodity prices, to restrain stock speculation, to take the peaks off the business hills and fill in the gullies requires a perception and intelligence and a measure of power no one of which has yet been discovered in common mortals. These ends call for clear vision not only in the past and present but into the future. They call for an intelligence and ethical disinterestedness which will enable the guiding body to read correctly the significance of circumstances and come to a prudent decision. Having seen clearly and decided wisely the governing board must persuade or coerce the member banks, be they great or small, to co-operate in such a fashion that the clients of the banks will effectuate the purposes of the council on distant Olympus.

Concentration Will Shorten Distance of Transmission

On the whole it will be easier for the Reserve board to deal with a dozen banks than with nine thousand banks of varying size. The Reserve board must first persuade the managements of these great banks that the policies adopted are sound and the ends in view desirable. The necessity for securing the voluntary co-operation of these banks may have a sobering and wholesome effect upon the judgment

of the board. It should restrain any will-o'-the-wisp aspirations as well as any undue subordination to vocal sectional partisans. If concentration in banking results in confining the Reserve authorities more closely to their traditional functions, it will be a definite gain to the community as well as assuring a longer and on the whole happier existence to the Federal Reserve System.

Small Banker Will Seek Refuge in Reserve System

In another sense the usefulness of the Reserve system may be increased as a result of the changes now taking place in American banking. There are still thousands of independent bankers in this country who are clinging to their institutions and refuse to sell control. Their fortitude is assailed partly by the fear of competition with a Titan of unequal size, partly by a consciousness of weakness which the greater competitor does not possess and partly by a sense of increasing isolation in a banking world in which his brethren one by one have yielded their independence and followed the crowd. The Reserve system is able to offer the unit banker many if not all the advantages of service which could be obtained by a surrender of identity. The hazards of deposit fluctuations, the embarrassment of inadequate funds during periods of seasonal strain, the danger of unforeseen currency demands, against all these membership in the system offers assurance of aid fully

as great as that which accrues to the various units of a multiple bank. Independent bond houses offer security service which in many respects is superior to that which the security affiliate of a great bank can provide to its branches, for it has the supreme virtue of disinterestedness. There are still large banks which have so far refused to be stampeded into branch expansion who can serve as correspondents to the small banker and provide foreign trade and exchange facilities comparable to those available to the branch of a great system. It is this combination of Reserve membership and private engagements which enable the small banker to withstand the tide of concentration—if he will. The greater danger to the unit banker's existence is the psycholological pressure of a mass movement. When everybody is doing it the small banker, cherishing his patrimony of independence, finds it increasingly difficult to reject the example of his brethren. His will becomes infirm and his intellect points less insistently to the folly of emulation.

CHAPTER XIV

Conclusion

A careful weighing of the evidence and the analysis and interpretation of the preceding pages indicate two things.

No Emergency

In the first place it cannot be said that an emergency exists in any sense of the word which would call for hasty action on the part of Congress. The structure of our banking system now undergoing change after long and useful service is not about to topple. Congress may after deliberation, which we trust will be mature and profound, do one of three things. It may decide to discourage the present process of concentration. It may decide to coast along and do nothing at all or it may comply with the Comptroller's suggestion and grant the current movement greater latitude. Whatever course it finally adopts there is no occasion for haste.

No Case for Large Scale Banking

The second conclusion which may be drawn from this study is that the case between large scale

banking and unit banking in this country is left a stalemate. If we consider the evidence coming from Canada and Great Britain we may say that the verdict leans toward the unit bank. We are conscious that such a conclusion runs contrary to the popular tide, meaning by this the preponderance of present official and student opinion.

An Old Brief

The latter has degenerated into a bald advocacy of branch banking. The brief as presented regularly and all too frequently is an unembellished statement of the case for branch banking as this writer heard it some years ago as an undergraduate student. Among the thaumaturgic qualities of such a banking structure we will have greater mobility of bank credit, more uniform interest rates, better and more complete banking service extending to the most modest hamlet, more intelligent and enlightened management, etc. The tiresome tabulation has been repeated *ad nauseam* in the guise of acute banking analysis. The virtues of the branch system have been so apparent that a note of impatience with the refractory die-hards has become part of all recent discussions.

Originality in Official Quarters

The present Comptroller must be credited with some originality in this matter. He offers the

assurance that a branch system will give us a safety not afforded by unit banks, that it will enable the banks to earn greater profits (a timely appeal to the stockholder) and that it will tend to diminish the power of the great banks in New York. Thus he appeals to the depositor, the proprietor and speculator, and finally the legislator.

An Advantage in Safety

These points have all been weighed carefully in the past pages. The great bank offers slightly better safety to the depositor than the small bank not because losses are actually eliminated but solely because the stockholder has a greater capacity for absorbing punishment. A second reason is that great banks are seldom permitted to fail. The consequences would be so disastrous that other banks through the compulsion of self-preservation must come to the rescue. The very fact which permits the depositor to relax his vigilance admonishes the stockholder to exercise it intently and continuously.

Banking Not Suited to Mass Methods

On the whole it cannot be said that banking is suited to mass methods. The product is essentially intimate and personal. The point of diminishing returns as revealed by English experience and suggested by American methods is reached at a rather early stage of growth. Our big banks are already

displaying the clutter of excessive size, co-ordinating departments, personnel departments, efficiency departments. Economies realized are soon offset by increased costs of "co-ordination."

Scales Swing in Favor of Unit Bank

The scales are swung definitely in favor of the unit bank when we consider its position in the community and compare it with the corresponding position of the branch bank in Canada, England and California. The country loses something which large scale banking can never recapture.

The Demand for Prophecy and Advice

The conclusion thus far is negative and the reader expects more than that. He feels that the student is in a better position to discern those portents which disclose the secret of the future. Also he wants practical advice. Banking concentration is not a theory. It is a vital, concrete problem. What shall be done about it?

The End of the Present Movement

How far will the present movement proceed? This calls for a consideration of the forces driving it onward. Holding as we do a belief in the dynamic quality of business intelligence and having found the rational motives for concentration wanting in power we come to the will of the leaders.

These men are far removed from the bread and butter pressure of material want. Gain in terms of monetary income, whatever it may mean to the stockholders, has little significance for them.

Vanity

But vanity is a psychic appetite which rarely finds complete satisfaction. Everyday life is replete with the evidence of its force. The bank clerk works for $25 a week that he may acquire some of that respectable aura which the position carries with it. Great social leaders eagerly lend their names to petty advertisements for the sake of evanescent distinction. Men send giant edifices toward the heavens which fail to justify themselves on any income calculation—but they bear a name and as long as steel and stone cling together they will be graceful monuments to a universal craving. Economic considerations never justified the Tower of Babylon nor the Pyramids of the Pharaohs.

Power

The second psychic propellant is the desire for power. A great bank occupies a throne like that of Caesar. A nod of acquiescence launches vast projects. A scowl of disapproval freezes the arteries of enterprise. It is characteristic of the world's great banks that they tend to retain control even after success crowns the adventure. In our own

country bankers occupy the seats of the industrial mighty and often do they dominate the counsel.

Rivalry

A third force driving the banks on to greater size is institutional rivalry. Here is the confession of a banker. "We were once near the top. Our rivals have grown by direct expansion but chiefly by union. We are now bigger than we ever were but by comparison with others we have never been so small. This cannot be. We are busy now making overtures and concluding alliances. Nor shall we cease until we are again where we once were—near the top." The case of the London bank which upon hearing of a merger between two rivals arranged for seventeen new branches within twenty-four hours is very much in point.

Profits of Promotion

By historical analogy and some direct evidence the profits of promotion play a part in the present movement. They were a potent force in the feverish era of consolidation during the early part of the century. Bank stocks are riding the crest of popular favor. It would argue bromidic indifference to profits to maintain that such an opportunity would be ignored. When a bank stock sells at more than seven times its book value and a number of others at more than four times their apparent worth

at prices which in many instances yield less than 2 per cent. It represents a field of clover for the shrewd promoter. A table of 102 banks in the metropolitan district tabulated by the *New York Times* showed not a single bank stock selling for its book value or less and only five which yielded more than 4 per cent. on their market price. Other significant facts compiled by the Standard Statistics Company show the twenty-two leading banks of New York City selling at 26.5 times earnings and 2.92 times book value. The study indicates an average annual appreciation of bank stocks during a twelve-year period 1918-1929 of about 75 per cent. per annum, this being approximately ten times the rate of increase of earnings. The normal state of the American speculative temper must be reckoned as the El Dorado of the promoter.

Economic Motives

To some extent economic motives play a part in the tide of concentration. Among these the strongest is probably the desire to achieve a more perfect balance among the various services which the great bank today renders. The nature of current bank rivalry indicates that the trust business is at present more highly desired than any other. Each trust account gives the bank a virtual stranglehold on one or more deposit accounts and furnishes a certain outlet for securities. Among

other economic motives are the desire to participate more effectively in security distribution and to acquire better foreign trade credit facilities, both of which make an appeal to the powerful client. These motives, however, are no longer the prime impelling motives. Mergers are proceeding long after an excellent balance in services, well developed security affiliates and ample foreign trade facilities have been acquired.

Forces from Below

The motives here noted, the vanity of the leaders, the desire for power, institutional rivalry, the profits of promotion and economic attractions, all come from above. They constitute the intellectual and emotional emanations of the leaders of the movement. The desire for gratification is met partly from below by the masses whose adhesion the leaders seek. Two of these centripetal forces have already been noted in the previous chapter, *i.e.*, the unit banker's sense of weakness and increasing isolation and the power of crowd psychology. An additional force acting upon the independent banker is the attractive price offered for surrender of control. It is impossible to cite specific instances authoritatively but it is common knowledge that many a small banker's desire to remain independent has been dulled by dazzling offers for his stock.

Watered Capital

This form of bait has been most commonly used in the establishment of those branch and group systems which, according to high authority, are destined to assure the American depositor a greater measure of safety. It is to be emphasized in this connection that the exaggerated prices paid for such bank stock although going to the banker who has been bought out are carried as the capital of the group or branch system thus giving the latter an entirely false picture of security. The funds paid out as an inducement over and above the actual capital residue of the purchased bank are in no sense a protection to the depositor although they are made to appear as such.

Thus we find forces operating on both parties to pull the scattered outposts of our banking system into a limited number of great organizations.

Resistance

On the other side we have certain forces which are resisting the process of concentration.

Foundation of Unit Banking

The first of these is the long life of the existing unit banking structure. Unlike England and Canada and other European countries with which comparison has been made our unit banks have had an opportunity to send their roots deep into Ameri-

can custom and consciousness. We have adapted ourselves to the unit bank and the unit bank in turn has adapted itself to the pace and needs of modern America. It is by no means a perfect system but with its faults it has served us well. As we look at the ponderous and impersonal structures which serve other lands the desire to emulate chills in our bosom. The unit bank and the unit banker have now served the nation for sixty-five years. They have laid a foundation which may resist the leveling forces more effectively than it did in other countries.

Hostility of Law

In the second place there is the hostility of the law. That is based perhaps largely on a fear of great units and monopoly. Its matrix is much the same as that from which the original Interstate Commerce Act and the Sherman Anti-Trust Law sprang. Although the apprehension of our legislators based upon the supposed turpitude of big business and the iniquitous intent of monopoly has little foundation it nevertheless serves to check the movement toward greater multiple banking organizations.

Federal Reserve System

It is now that the Federal Reserve System must appear as the comforting bulwark of the small banker who dreads the encroachments of the giant

banking octopus. It can assure him of many of the advantages which are offered as compensation for the loss of independence.

Absence of Definite Economic Attractions

Finally there is the widespread perception among bankers particularly, a perception not shared generally by students and Government officials, that the profession of banking is not suited to the methods of Detroit. The Whaley-Eaton Questionnaire referred to in an earlier chapter shows a strong resentment of the Comptroller's intimation that the unit bank is unsafe and unprofitable. This resentment springs partly from pride but also, this writer is convinced, from a more accurate knowledge of the facts.

Ultimate Concentration Not Inevitable

In spite of all this it appears that for the time being the forces of concentration are in the ascendant. Unless checked our unit banks are destined to succumb in increasing numbers. However, as the nature of the problem becomes better understood and the current illusion of superficial glorification of branch banking is checked by exposure, the tide may be definitely halted. Although the concentration movement is devoid of that sinister peril so readily envisioned by our legislators it is equally

devoid of substantial economic justification. The ultimate of the movement is in no sense inevitable.

Legislation

In its deliberate consideration of the problem the legislature may bear certain proposals in mind. These are offered not as final solutions but merely as starting points for further reflection and investigation.

Double Liability Applied to Holding Company

The device of the holding company may become the instrument wherewith the bank stockholder can evade his full obligations to the depositor. In justice to the latter as well as to those stockholders who are unwilling to resort to such a circumvention of responsibility it may prove desirable to impose double liability upon the owners of holding company stock. The same end may be achieved by limiting the bank stock held by any holding company to one-half its assets.

Supervision of Holding Company

If we grant the desirability of state supervision of banking then it might be well to subject the holding company to the same visitorial powers. Bank examination has proved a very salutary check to reckless banking in this country. To prevent the purpose of supervision from being defeated the

final seat of control of a group of banks should be compelled to submit to inspection even as the subordinate members. The state makes an abominable manager and its record as a direct participant in business is sorry but as a policeman it has done fairly well. Government supervision will not usurp that discretion and judgment which properly belong to management.

Discouraging Pyramids

The pyramiding of holding companies and the concentration of control in the hands of a small fraction of the owners merits further study. One holding company with 51 per cent. of the stock of subordinate banks places control in the hands of the owners of 26 per cent. of the stock. If the owners of the 26 per cent. in turn organize, final control rests in the hands of the group which owns anything above 13 per cent. of the original stock. The process is accelerated by the division of stock into voting and non-voting shares so that finally a very small fraction of the original proprietors in fact control vast underlying interests. The unsophisticated stockholder may require some protection.

No Urgent Need for Legislation

In spite of official opinion to the contrary there appears to be no urgent need for increasing liberali-

zation of the National Bank Act and the Federal Reserve Act to permit branch expansion.

Greater Safety an Illusion

The amalgamation movement in the country is still in that stage where only strong banks are admitted to new combinations. Our groups and chains and great banks are not interested in the acquisition of weak banks and it is the latter which need protection. Any hope that greater latitude will solve the problem of bank failures is illusory. In fact through greater isolation of the unwanted banks it may aggravate their condition and thereby increase their susceptibility to failure. The Comptroller in his testimony before the Currency and Banking Committee of Congress should have given specific instances where a bank on the brink of failure was saved by admission to a branch system. Yet it is his contention that the removal of obstacles to branch bank expansion will relieve us of the affliction of numerous bank failures.

False Hope for Investor

Nor will such a change in the law help the investor in the long run. He may profit temporarily through an appreciation of his stock resulting from the common belief that a hundred banks in union can earn more than the same banks operating separately. Not only has this effect never been demon-

strated but on the contrary there is substantial evidence to indicate that just the opposite results.

Movement Does Not Deserve Legislative Assistance

If the present movement brings an increasing impersonalization of banking the national legislature should at least not aid the process or do so only if outstanding compensating advantages can be discovered.

Responsibility for Bank Failures Rests Upon States

The full responsibility for our present bank failures outside of the vicissitudes of regional and occupational fortune rests upon the states. They have been deplorably lax in the chartering of banks and have ignored their responsibility to depositors through failure to insist upon adequate capital margins. There is no excuse for tolerating a condition which assures safe banking only during boom periods and is a constant threat to the depositor at all other times.

Birth Control for Banks

On behalf of necessary bank contraception it is suggested that the earlier limit of $50,000 capital for national banks be restored and that such capital become a condition of membership in the Federal Reserve System. In order to be certain that the community actually needs the bank and to relieve

officials of the responsibility of making the decision it might be well to insist upon citizen petitions before granting charters. No charter, for example, should be issued to a bank in a community of less than 3000 unless a petition avowing a need for it is signed by at least 100 citizens, the necessary number of names being graduated according to the size of the community.

Minimum Capital for Safety

Our Federal and state laws all require certain reserves to be maintained against deposit liability. This is an assurance of liquidity but not necessarily of safety. The latter appears to be the Achilles heel of our unit banking system. Why not insist upon a ratio of capital funds to deposits since the capital is the proprietary hostage to prudence? Larger capital will provide a greater margin for the absorption of losses and thus be a greater protection to the depositor. It will be recalled that the ratio of capital funds to deposit liability is lowest in that group of banks analyzed in this study known as the Small Banks in Distress Areas. About three-quarters of our failures occurred in this group.

Purpose and Effect

The object of these suggestions is to increase the strength of each individual bank, reduce the number of banks and impose obstacles to irrespon-

sible manipulation of banks through holding companies. It will be argued that these restrictions in the Federal law will force banks out of the national bank and Federal Reserve systems. Which will have certain advantages. It will limit future failures largely to state institutions and place squarely upon the states the responsibility for laxity and excessive liberality. The banks that withdraw from the Federal Reserve System are thereby abandoning those defences which are intended to aid them in resisting the encroachments of great banking systems. They will become more susceptible to absorption or failure. The national charter will remain the palladium of independent banking and this should bring in due time an appreciation from the public which will offer compensation for the added restraints.